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OF

CURRENT INFLATIONARY

AND

DEFLATIONARY TENDENCIES

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CONTENTS

PREFACE

This Survey of Current Inflationary and Deflationary Tendencies is intended to meet in part the need for information on world economic conditions and trends. In considering the needs for such reports the Economic and Employment Commission, during its second session, stated that the United Nations Secretariat "should be left free to prepare, where appropriate in co-operation with the specialized agencies, and publish such reports and analyses as it may find necessary and feasible in the light of changing world economic conditions and the consequent changing requirements of the Assembly, the Council, and its commissions and sub-commissions". The draft of this report was informally made available to the members of the Economic and Employment Commission, several of whom urged that it be completed and published as early as possible.

This report was prepared by the Economic Stability Section of the Division of Economic Stability and Development of the Department of Economic Affairs.

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INTRODUCTION

This survey analyses for selected countries the problems of deficiency or excess in effective demand leading to unemployment or inflation respectively. The countries have been chosen so as to illustrate the problems in question in all parts of the world. These countries are:

1. The United States of America, where the question of a possible recession or depression in the near future is examined;

2. The United Kingdom, France, Italy, Poland and Yugoslavia, where the various patterns of inflationary pressure in devastated Europe are considered;

3. India and Latin America, where inflation in under-developed countries is discussed and its implications for the problems of development are examined.

Owing to the lack of adequate information, the survey is in some instances incomplete and subject to error. In view of the extremely rapid changes in the present economic situation it was also difficult to keep it quite up to date. It is hoped, nevertheless, that the analyses will be useful for the understanding of fundamental economic problems of the present world.

SUMMARY

United States

A large part of the world is at present subject to inflationary pressures. Even in the United States, where output has been greatly expanded as a result of the war, inflationary price movements have taken place. Unlike conditions in the rest of the world, however, in the United States there is already a serious problem of a recession during the next year.

The factors which have contributed to the high level of demand in the United States in the post-war period are: (1) the high levels of consumption of durable goods, of business investment in plant and equipment and of residential construction, resulting on the one hand, from pent-up demand, and on the other, from the improving supply position; (2) large net exports, resulting from urgent needs of foreign countries and financed in large part by loans granted by the United States Government; (3) the rise in inventories, which had been low in relation to shipments, to levels approximating the pre-war relationships.

An analysis of the prospects indicates that several of these factors will decline in significance and that effective demand may fall below the available supply during the next year. In the absence of new large United States loans, net exports will undoubtedly decline as a result of the world shortage of dollars. The voluntary accumulation of inventories may also be expected to come to an end as stocks approach a normal relationship to shipments and sales.

Although there is a very large pent-up demand for houses and the supply of building materials is constantly improving, the present high construction costs may render much of this demand ineffective. The supply of automobiles is increasing more slowly than had been anticipated, largely as a result of steel shortages. The increases in building and in output of automobiles, therefore, appear to be too small to fill the gap caused by the probable declines in inventories accumulation and in exports. Important changes in governmental policy with respect to foreign loans and domestic taxation may of course alter the situation materially.

There is a widespread belief that if a recession should occur, it would be of a mild "corrective" nature. A recession may, however, have a seriously depressing effect on business investment in fixed capital, which in 1948 will be much less conditioned by urgent needs of post-war readjustment. Although the unsaturated demand for automobiles and houses will have a mitigating influence, large portions even of that demand may cease to be effective once the recession sets in. In that case, a serious depression instead of a mild recession may well be the result.

Devastated Europe

The problem of inflationary pressure in devastated Europe may be stated as follows:

The requirements for savings are higher in relation to national income than before the war. Indeed, owing to reconstruction needs, the rate of investment, public and private, is higher in relation to the national income than before the war. Taxation, which in many instances is hardly adequate to cover the administrative budget, and imports of capital from abroad (net imports of goods and services) leave the portion of investment to be financed by saving at home at a higher level in relation to national income than before the war. (Military expenditures, by increasing the administrative budgets, have aggravated the situation in many countries.)

At the same time, there is a tendency to save less than before the war, for a number of reasons:

1. Consumption per head, especially of necessities, is lower.

2. There is a natural tendency to replenish the consumers' stocks of durable and semi-durable goods, which were depleted during the war.

3. There existed after the termination of hostilities a pent-up demand in terms of liquid savings accumulated during the war.

4. As a result of large price increases during the war and after liberation, there is in varying degrees in most of the countries concerned, a lack of confidence in the value of money. This creates a tendency to avoid saving in money or securities and results either in increased consumption out of current income or in hoarding of goods. The latter reduces the savings available for reconstruction in the same way as increased consumption.

In such a situation the increase in prices raises profits to the point where savings out of them satisfy the requirements for savings. In the process, the relative share of wages in the national income falls, and scarce essential consumption goods are distributed very unequally by the price mechanism.

One way of tackling the problem is through a comprehensive system of controls and rationing such as was developed during the war in the United Kingdom. If the Government secures the total supply of essential goods at fixed prices and distributes it through a rationing system, the prices of essentials to consumers are fixed because the demand for them is adjusted to the supply by the issue of ration coupons.

Of the countries considered, only the United Kingdom and Yugoslavia (except for a limited free market in food) practise this system.

Other countries have been unable to introduce it for political and administrative reasons.

The United Kingdom experience shows that even in an economy controlled in this manner, important loopholes may exist. Although in pressing the economy to the limits of its capacity the Government was able to avoid the inflationary pressure upon prices of essentials, it permitted the depletion of its inventories of basic materials. As a result, it suffered from a severe coal crisis, when winter snow disrupted transportation.

In the other countries surveyed (France, Italy and Poland) only partial controls are in operation, the general pattern of which is as follows. The Government purchases from the farmers only a part of their surplus and distributes it through a rationing system. The rest of the farmers' surplus, which is substantial, appears on the free market at much higher prices. The position with regard to industrial commodities is similar. As rations are on the whole inadequate, even the people with low incomes frequently buy in the free market and are therefore affected by free market prices. However, the system benefits them to the extent to which the cheap rationed goods constitute a larger share of the consumption out of low than out of high incomes.

As the partial controls do not solve the problem of inflationary pressure, financial measures aiming at its reduction become more important in these countries than in economies equipped with a fairly complete rationing system.

One type of financial measure consists of monetary reform. In Poland and Yugoslavia, upon liberation, notes in circulation were exchanged for new currency, and a large part was blocked. (Blocking also applied to banking accounts.) In this way, the countries not only solved the problem of pent-up demand in terms of accumulated liquid savings, but they created a virtual shortage of cash. In the absence of substantial banking credits to persons and non-nationalized firms, this shortage provided an inducement to accumulate cash balances out of current income. In France and Italy, which had no monetary reforms, the pent-up demand was largely eliminated by a rapid increase in the general level of prices. In the United Kingdom this demand is still an important potential factor, but it is prevented from becoming effective by the system of direct controls referred to above. Conversely, the elimination of pent-up demand in terms of accumulated liquid savings in other countries removed only one reason for the inflationary pressure, and therefore it could not by itself solve the problem.

Another financial measure which reduces inflationary pressure is direct taxation. In the United Kingdom, severe income taxation supplements effectively the direct controls. In Poland and Yugoslavia, an important positive factor in this respect is the nationalization of large

enterprises, which, from the financial point of view, is equivalent to a hundred per cent profit tax. Both France and Italy have a very low income tax and are in urgent need of tax reform. However, even heavy taxation of higher incomes cannot replace a rationing system. In particular, it is hardly instrumental in solving the problem of more equitable distribution of scarce food supplies, for it takes a very drastic income tax to reduce substantially the food consumption of the richer population.

So far, we have discussed the adjustment of demand to a given supply position. It is still necessary to consider briefly the main factors determining the latter. These are: *(a)* the general scarcity of food and *(b)* the scarcity of coal which hampers industrial production in many European countries (as in the United Kingdom, France and Italy). These scarcities cannot be fully overcome by imports, partly because of the world shortage of food and coal, and partly because of a limited supply of hard currencies in which most of these imports have to be paid. These currencies are obtained either from foreign loans or from exports. The supply of loans is of course determined by the policies of the lending countries. Expansion of exports to the hard currency countries is difficult for several reasons. Many of the goods which the hard currency countries would want to import are either investment goods needed for reconstruction of devastated Europe itself, or else essential consumption goods. Others—e.g. high-quality goods such as china and woollens, for which there is great demand in the United States—are already being produced at capacity rates, so that exports are limited by supply conditions. Larger exports of other goods are made difficult by high costs of production, customs duties, import restrictions, etc.

The situation of devastated countries is now aggravated by two factors: *(a)* the poor harvests caused by very adverse weather conditions and *(b)* an increasing dollar shortage. The latter results from the discontinuation of UNRRA and from a rapid spending of previously granted dollar loans which are not being fully replaced. The rapid spending has been partly brought about by the rise in world prices after the lifting of controls in the United States in the middle of 1946. The large volume of government expenditures abroad was a contributing factor for some countries.

The present aggravation of the supply position has already resulted in a reduction of rations in countries affected. Where only partial controls are in operation there has been a substantial rise in prices of essential goods.

Under-developed countries

The under-developed countries of Latin America and Asia have not escaped the inflationary pressures of the war and post-war period.

These countries have experienced a great increase in demand. In India, the initial rise in demand during the war was due largely to an increase in government expenditure which was not financed by taxation; in Latin America, it resulted primarily from a large increase in exports which was not balanced by an increase in imports.

It is true that the under-developed countries did not, in general, experience any reduction in productive capacity such as occurred in devastated Europe. The inflationary pressure, however, was strong because the supply, especially of agricultural goods, was relatively inelastic in response to the increased demand. Since the percentage saved out of additional income is rather small in under-developed countries, there must be a fairly sharp increase in supply in relation to the primary increase in demand in order to prevent inflation. The supply was, however, inelastic both because of inadequate imports of machinery, fertilizers and raw materials, and because of the unfavourable institutional framework, especially in agriculture.

Inflationary pressures have continued both in Latin America and India even after the end of the war. In these countries, as in Europe, a contributing factor is the pent-up demand for investment and consumption goods, supported by a large volume of liquid savings accumulated during the war. A second factor in most countries concerned is the large government deficit due in part to development expenditures, which is far in excess of pre-war levels. In Latin America, a third factor has been the high and even increasing level of exports after the war as a result of full employment in the United States, the demands of devastated countries supported by relief grants and foreign loans, and the low rate of recovery of alternative sources of supply.

Both in India, and, in general, in Latin America, imports have so far failed to solve the problem of inflation. One reason for this is the world shortage of food. The second is the world shortage of machinery, which has made it difficult to increase production of industrial goods.

Any estimate of the course of events in India and Latin America in the near future must necessarily take into account the large-scale development schemes upon which these countries are likely to embark. Although a large part of the investment involved will be financed by balances of foreign exchange accumulated during the war, or by foreign loans, a substantial part will have to be financed at home. If direct taxation is not increased, inflation will follow just as it did during the war. However, even if development expenditures are offset by direct taxation, the problem of inflation in food prices will not be solved, because taxation of higher incomes will hardly reduce the demand for food. In the long run, an increase in food production will

doubtless constitute a very important part in the development programme of under-developed countries. This will require fundamental social and technical changes in the agricultural economies. In the short run, however, the countries undertaking the development of their resources will have to import not only machinery, but food as well.

PART I

THE PROBLEM OF FULL EMPLOYMENT IN THE UNITED STATES OF AMERICA

The purpose of this survey is to analyse the over-all demand and supply position in the United States from the point of view of the maintenance of full employment. In the first section we analyse the elements which contributed to the achievement of almost full employment in 1946 and in the first half of 1947. In the second section we attempt to answer the question whether this level of employment is likely to be maintained throughout the second half of 1947 and in 1948. In this analysis we use the new estimates of national income, etc., as given in the Supplement to *Survey of Current Business* (July 1947) and the *Midyear Economic Report of the President* (July 21, 1947).

SECTION 1. THE ECONOMIC SITUATION IN 1946 AND THE FIRST HALF OF 1947

In the United States of America the year 1946 and the first half of 1947 was a period of nearly full employment. Over the whole period unemployment only slightly exceeded two million, and constituted, on the average, about four per cent of the civilian labour force. The distribution of manpower in the period from the end of hostilities to the middle of 1947 is shown in the table below.

Table 1

LABOUR FORCE, EMPLOYMENT AND UNEMPLOYMENT[1]

	1945		*1946*				*1947*		
	July	Oct.	Jan.	April	July	Oct.	Jan.	April	June
	(*Millions of persons*)								
Total labour force	67.5	63.8	59.5	60.3	62.8	61.2	59.5	60.7	64.0
Armed forces	12.1	10.6	6.2	3.9	2.7	2.2	1.7	1.5	1.4
Civilian labour force	55.4	53.2	53.3	56.5	60.1	59.0	57.8	59.2	62.6
Employed	54.4	51.6	51.0	54.1	57.8	57.0	55.4	56.7	60.0
Government	6.0	5.8	5.6	5.7	5.5	5.6	5.4	5.4	5.4
Private non-agricultural	38.5	37.0	38.7	40.2	42.3	42.8	43.5	43.4	44.2
Agricultural	9.9	8.8	6.7	8.2	10.0	8.6	6.5	7.9	10.4
Unemployed	1.0	1.6	2.3	2.3	2.3	2.0	2.4	2.4	2.6

[1] Detail will not necessarily add to totals, because of rounding. Source: Department of Commerce.

Private non-agricultural employment fell somewhat after VJ-Day, began to increase shortly afterwards, and by the middle of 1946 reached a level 3.8 million higher than at the end of the war. This change was accompanied by some reduction in working hours. Even if measured in man-hours, however, private non-agricultural employment was somewhat higher in mid-1946 than in mid-1945. From mid-1946 to mid-1947 there was a further increase in this type of employment by 1.9 million. Agricultural employment was at about the same level in July 1946 as in July 1945; in June 1947 it was 0.4 million higher. The increase in total civilian employment from mid-1945 to mid-1947 was 5.6 million, and unemployment increased by 1.6 million, which makes an increase in the total civilian labour force of 7.2 million. The total demobilization over that period amounted to 10.7 million. The difference of 3.5 million is accounted for by withdrawals from the civilian labour force, especially of women employed in industry during the war, and by some veterans going to school.

The high level of private civilian employment in the period considered, in particular in 1946, raises two questions. The first may be called the supply question. How was it possible to provide facilities such as equipment, etc. for this level of employment in spite of a basic change in the structure of demand resulting from the reduction of enormous government expenditures, as shown in the table below? The second, which may be called the demand question, is: what was the source of the demand which absorbed the national product corresponding to full employment? We shall take up first the supply question.

There are many factors which contributed towards the answer to this question. Labour was absorbed to a great extent by a type of employment which did not require new fixed capital equipment, i.e. trade, finance, services, etc. In other cases, there still existed some unused capacities in the industries which increased their employment. These changes, however, were possible only because of the high mobility of labour. Finally, there is no doubt that reconversion made great strides over a rather short period of time. In general, under the high pressure of demand, both labour and equipment showed a great adaptability to the changes in the structure of demand.

This leads to the second question: what was the source of the high demand which was able to absorb the national product at full employment?

In general terms, the answer appears simple. During the war, the demand both for certain consumption goods and investment goods could not be satisfied owing to the conversion to war production.

As a counterpart, there was an accumulation of large personal savings and company reserves. Thus a large pent-up demand arose both in terms of unsatisfied needs and in terms of savings which provided the wherewithal to satisfy these needs.

Table 2

CHANGES IN GOVERNMENT EXPENDITURE IN RELATION TO GROSS NATIONAL PRODUCT

	Second quarter 1945 (annual rate)	1946	First half 1947 (annual rate)
	(Thousand million dollars)		
1. Total government expenditure on goods and services	96.4	30.6	27.5
2. Government wages and salaries[1].....	37.0	21.2	17.3
3. Gross national product	220.2	203.7	225.0
4. Government expenditure on private product (1 — 2)	59.4	9.4	10.2
5. Private gross national product (3 — 2) ..	183.2	182.5	207.7
6. Government expenditure on private product as percentage of private gross national product	32.4	5.2	4.9

[1] Inclusive of food and clothing of armed forces.

Source: Department of Commerce. The data for the first half of 1947 are taken from the *Midyear Economic Report of the President.*

Note: The table shows the reduction of the role of government expenditure in gross national product. From the point of view of private employment, it is only that part of the government expenditure which is not spent on wages and salaries (inclusive of payment to armed forces) that is relevant to the question posed in the text. See, therefore, especially, lines 4 and 6 of the table.

However, when we look at the problem more closely it is not as simple as it appears, because the supply both of durable consumption goods and investment goods was limited, in spite of the adaptability of equipment and labour which was stressed above. The pent-up demand for these goods, which was potentially adequate to create full employment in the United States for a few post-war years, could be effective in the period considered only to a limited extent. Thus, in order to answer the "demand question" we must consider in some detail the structure of national expenditure which was adequate to secure almost full employment. This is shown in table 3.

Table 3

THE NATURE OF DEMAND FOR THE NATIONAL PRODUCT IN 1946 AND IN THE FIRST HALF OF 1947

	1946		First half 1947 (ann. rate)
	(Thousand million dollars)		
Consumption of durable goods	14.9	Determined	19.5
Residential construction	3.3	mainly by	4.2
Business investment in fixed capital	17.6	supply conditions	22.6
Government expenditure on goods and services	30.6	Determined mainly by government policy	27.5
Net exports	4.8		10.0
Consumption of non-durable goods and services	128.8	Determined mainly by demand conditions	138.5
Increase in inventories	3.7		2.7
Gross national product	203.7		225.0

Source: Department of Commerce. The data for the first half of 1947 are taken from the *Midyear Economic Report of the President.*

Expenditures on durable consumption goods, on residential building and on business investment in fixed capital were determined in 1946 mainly by supply conditions. This was also true to a great extent in the first half of 1947, although as a result of rapidly increasing supply in some lines, demand began to play an increasing role as a limiting factor. Another item which was determined independently of consumers' demand was the government expenditure on goods and services. Another item similar in a way was net exports of goods and services.[1] This item, although the result of net demand of foreign countries, was to a great extent determined by the policy of the United States because it depended on foreign loans granted to other countries by the United States Government. The rest of the national expenditure was accounted for by the demand of consumers for non-durable goods and services and by the accumulation of inventories.

Consumer expenditure on non-durable goods and services was determined primarily by the level of disposable income (personal income after taxes), which, given the value of the gross national product, depends on the existing taxes, transfers (veteran benefits, unemployment compensation, etc.), interest on public debt, and the part of the gross national product retained by companies in the form of capital consumption allowances and undistributed profits. (For 1946

[1]The excess of exports of goods and services over imports exclusive of unilateral transfers such as UNRRA assistance, etc., which are included in government expenditure on goods and services.

and 1947 the derivation of disposable income from the gross national product is given in the Appendix.) It should be noted that largely because of the increase in veterans' benefits the level of disposable income was higher in relation to the gross national product than during the war. This in itself tended to raise the volume of consumption of non-durable goods and services. In addition, consumer demand for these items rose substantially in relation to the disposable income, as is shown in the table below.

Table 4

DISPOSABLE INCOME AND CONSUMPTION

	1940	1944	1946	4th quarter 1946 (ann'l rate)	1st half 1947 (ann'l rate)
			(Thousand million dollars)		
Disposable income	75.7	146.0	158.4	168.0	169.6
Personal consumption	72.1	110.4	143.7	154.9	158.0
Durable goods	7.9	6.8	14.9	18.2	19.5
Non-durable goods and services	64.2	103.6	128.8	136.7	138.5
Non-durable goods and services as percentage of disposable income	84.8	70.9	81.3	81.3	81.6

Source: Department of Commerce. The data for the first half of 1947 are taken from the *Midyear Economic Report of the President.*

During the war (in 1944), the ratio of expenditures on non-durable goods and services to the disposable income was depressed, mainly as a result of shortages in supply. In 1946 the ratio returned to a level approaching that of pre-war. (It is, as a matter of fact, a little lower; and this was to be expected, for the real income in 1946 was substantially higher than in 1939, and this ratio tends to fall slowly with increases in real income.) This return to the pre-war pattern is the result of a fairly ample supply of non-durable goods and services and, in general, of the return to normal spending habits.[1]

[1] Although the total expenditure on non-durable goods and services, taken in relation to disposable income, conformed in 1946 to the pre-war pattern, such was not the case if expenditure on non-durable goods and that on services are considered separately. The expenditure on non-durable goods was "too high" and that on services "too low". This may be explained by the much greater increase in prices of non-durables than in those of services, while the increase in the joint price index of these two items differs little from that of the general price index of all consumption goods and services.

The remaining gross national expenditure (see table 3) is accounted for by an increase in inventories.[1] The increase in inventories in the period considered reflected the general rise in output and sales and also the fact that inventories in wholesale and retail trade were supplemented where their level was unusually low in relation to sales at the beginning of 1946. It is probable that even by the second half of 1947 the process of building up these inventories to their "normal" level in relation to sales has not been fully accomplished. The rate of accumulation of inventories was not determined solely by demand. In many instances, as a result of supply conditions, the traders did not succeed in building up their inventories as quickly as they desired.

The next table shows the subdivision of the gross national product in 1946 into consumption, private investment, net exports and government expenditure on goods and services, as compared with 1944.

Table 5

THE STRUCTURE OF GROSS NATIONAL PRODUCT

	1944	1946	First half 1947 (annual rate)
	(Thousand million dollars)		
Consumption	110.4	143.7	158.0
Private investment	5.7	24.6	29.5
Net exports[1]	−2.1	4.8	10.0
Government expenditure on goods and services[2]	96.6	30.6	27.5
Gross national product	210.6	203.7	225.0

[1] Exclusive of Lend-Lease and other unilateral transfers such as UNRRA assistance, etc., which are included in government expenditure.

[2] Inclusive of government wages and salaries.

Source: Department of Commerce. The data for the first half of 1947 are taken from the *Midyear Economic Report of the President.*

It is interesting to consider why the price increases which followed the dropping of controls in the middle of 1946 did not adversely affect the employment situation. The rise in prices of food and of some raw materials caused a shift of income from consumers in the towns to the farmers and, as farmers usually save a larger proportion of their income than the urban population which was mainly affected by price increases in consumption goods, this might have reduced somewhat the demand for consumption goods. However, the

[1] Increase in the value of inventories adjusted for the change in the basis of the valuation.

fact that the ratio of expenditure on non-durable goods and services to disposable income did not fall suggests that this was not the case. More important was the increase in business profits and the rise in undistributed profits resulting from it. This reduced the ratio of disposable income to gross national income and thus tended to reduce the consumer demand. As a result there was a fall in expenditure on non-durable goods and services (which is determined by disposable income) in relation to gross national product. This, however, was offset by the rise in relation to gross national product of the consumption of durable goods in consequence of improved supply conditions.[1]

Table 6

CONSUMPTION PERCENTAGE OF GROSS NATIONAL PRODUCT

	1946	*First half 1947*
Consumption of non-durable goods and services	63.2	61.6
Consumption of durable goods	7.3	8.6
Total consumption	70.5	70.2

SECTION 2. THE ECONOMIC SITUATION IN THE SECOND HALF OF 1947 AND IN 1948

We shall now examine the employment situation in the second half of 1947. For this purpose, we shall try to estimate first the value of gross national product on the assumption that the present level of employment will be maintained in the second half of 1947, and second, the component items of national expenditure. (We shall use the same pattern as in the preceding section, cf. table 3.) The comparison of gross national product with the sum of the components of gross national expenditure will show us whether the level of employment is likely to be maintained.

The estimate of gross national product in the second half of 1947 is given in the Appendix. Taking into consideration the recent developments in wages and farmers' incomes, we arrive there at an estimate of gross national product of $236,000 million per annum in the second half of 1947.

We shall now estimate the various items of national expenditure in the same order as in the preceding section. Consumers' expenditures on durable goods were estimated for the first half of 1947 at

[1] This was not the only change in the structure of national expenditure from 1946 to the first half of 1947. There was a strong fall in government expenditure on goods and services in relation to gross national product, which was roughly offset by the rise in net exports.

$19,500 million per annum. The main change in this item might be expected from the increased supply of passenger cars. However, according to recent estimates of the industry, this increase would be no more than from 3.4 million passenger cars per annum in the first half of the year to about 3.8 million per annum in the second half, or by 0.4 per annum. (The low rate of increase results mainly from the scarcity of steel.) Allowing about ten per cent for exports and valuing at $1,700 per car, we obtain an increase of $600 million per annum. This would raise the value of consumers' expenditures to $20,100 million. Considering, however, that prices of durable consumption goods in general will be somewhat higher in the second than in the first half of this year, we assume that consumers' expenditure on durables in 1947 will be about $21,000 million. This estimate may appear too low, because apart from the increase in expenditures on new cars, there may be similar developments in other durable goods resulting from the improved supply position. However, it seems that the demand for some other durable goods has been saturated, and therefore that the purchases of such goods will fall in the second as compared with the first half of 1947. The $21,000 million estimate may therefore be considered reasonable as the net result of the changes in consumers' expenditure on durable goods in the second half of 1947.

Residential construction was proceeding in the first half of 1947 at an annual rate of $4,200 million. It is likely that it will be higher but not much higher in the second half. Although the supply conditions have improved considerably, the high costs of construction affect the demand unfavourably. We adopt for the second half of the year $5,000 million per annum.[1]

The annual rate of business investment in fixed capital (exclusive of residential building) was $17,600 million in 1946 and $22,600 million in the first half of 1947. It follows from the survey of expenditures on plant and equipment that in the first three quarters of this year it will be twenty-eight per cent higher than in the corresponding period of 1946.[2] Assuming the same relation for the whole year, we arrive at $22,500 million for 1947. Considering that the level in the first half of the year was nearly the same, this figure could be adopted for the second half, if it were not for the fact that the price of equipment is likely to be somewhat higher than at present. Taking this into account, we finally adopt $23,500 million.

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[1] All figures are understood to be adjusted for seasonal variations.

[2] *Survey of Current Business*, July 1947, page 12.

Net government expenditure for goods and services, which was $27,500 million per annum in the first half of the year will probably increase by something like $1,000 million in the second half.[1]

Net exports in the first half of this year reached an exceptionally high level of $10,000 million per annum. If no new loans from the United States are forthcoming, a drastic fall is to be expected next year as a result of a dollar shortage in the world, even if the lending of the International Bank is taken into consideration. Some falling off in the rate of net exports may already be expected in the second half of this year. An annual rate of $8,000 million seems a reasonable estimate.

Our estimate of the consumption of non-durable goods and services is based on the fact, stressed in the preceding section, that throughout 1946 and the first half of 1947, this consumption was eighty-one to eighty-two per cent. We assume that this trend will continue, and that the consumption of non-durable goods in the second half of 1947 will bear the same relation to the disposable income. The latter is estimated in the Appendix at $178,000 million on the basis of full employment gross national product of $236,000 million. Thus, we estimate the consumption of non-durable goods and services in the second half of 1947 at $145,000 million.

The rate of increase in inventories in the fourth quarter of 1946 has been estimated at $5,400 million per annum and in the first half of 1947 at $2,700 million. The position of inventories in the spring of this year has been recently characterized as follows:

"Aggregate business inventories are not too high in terms of the pre-war relation to sales. Inadequate stocks in some areas more than offset excess supplies elsewhere. They are, however, near enough to that relationship so that whether they are adequate or inadequate can depend on the attitude of management. Any remaining deficiency is a much less urgent source of demand than it was a few months ago. It does not warrant the assumption that inventory investment at the recent rate will continue for an extended period."[2]

Taking this into consideration, we adopt $2,000 million per annum as the rate of increase in inventories in the second half of this year.

We may now summarize the results of our analysis in a table corresponding to table 3 of the preceding section.

[1] This increase is accounted for mainly by the fall in government sales. (The above figure is the balance between actual government expenditures on goods and services and government sales.)

[2] "Expansionary Force of Inventory Outlay," by S. Morris Livingston, *Survey of Current Business*, May 1947.

Table 7

HYPOTHETICAL DEMAND FOR NATIONAL PRODUCT AT FULL EMPLOYMENT IN THE SECOND HALF OF 1947

	First half 1947 (annual rate)	Second half 1947 (annual rate) (hypothetical)
	(Thousand million dollars)	
Durable consumption goods	19.5	21.0
Residential construction	4.2	5.0
Business investment in fixed capital	22.6	23.5
Government expenditure on goods and services	27.5	28.5
Net exports	10.0	8.0
Non-durable goods and services	138.5	145.0
Increase in inventories	2.7	2.0
Gross national expenditure	225.0	233.0
Gross national product	225.0	236.0
Deficiency of demand	0	3.0

The analysis leads us to the conclusion that there will be a deficiency of $3,000 million per annum in the demand necessary to maintain full employment in the second half of 1947. This is certainly within the margin of error of the estimate, and it seems that no substantial increase in unemployment is likely in the second half of the year.

In fact, recent price developments indicate that for the remainder of the year at least the major economic problem will be that of inflationary pressure in food. There may be some question whether the rise in food prices may reduce the demand for non-food items and thus create some unemployment. Past experience suggests, however, that a shift in income from town customers to farmers is not likely to reduce the aggregate demand for consumption goods (see page 13). (This assumption is reflected in our estimate that the ratio of consumer expenditure on non-durable goods and services to disposable income will be the same in the second half of the year as in the preceding period.)

Let us now consider in a general way the situation in 1948. Net exports are likely to fall considerably further as a result of a world shortage of dollars, unless new United States foreign loans are forthcoming. Moreover, the voluntary accumulation of inventories will probably come to an end. In this way, the gap in demand would

become substantial. There will probably be further improvement in the supply of automobiles, the pent-up demand for which will still be far from saturation. This increase, however, may be moderate owing to the scarcity of steel. More important is a possible increase in residential building, which, however, may be hampered by high construction costs. Both factors combined are likely to be inadequate for filling the gap caused by tendencies mentioned above.

However, nothing conclusive can be said about the business outlook in 1948, owing to the uncertainty about Government policies. Important changes in governmental policy with respect to foreign loans and domestic taxation may of course materially alter the situation.

Should a recession in employment materialize in the course of 1948, what are likely to be its secondary effects?

An automatic consequence of a fall in employment would be, of course, a secondary reduction in consumption and a downward "adjustment" in inventories. Investment in fixed capital would probably be seriously affected as well, for the following reasons.

A few estimates have been made of the pent-up demand for plant and equipment on the basis of the neglect of replacement during the war and the necessary adjustment of productive capacities to the present levels of employment and output.[1] Taken in conjunction with the present rate of investment, these estimates seem to show, even allowing for a large margin of error, that the amount of plant and equipment in question will have been constructed by the end of 1947. It is true that in those calculations, innovations are not sufficiently taken into account, but the fact remains that what may be called the bare necessity of post-war readjustment will probably be reached by the end of 1947. Many additional investment plans may be under consideration by business, but their execution will probably depend more on the current situation than the investments that are being made in 1947. A primary recession in employment, caused by factors discussed above, and coming at the termination point of the fundamental post-war readjustment process of plant and equipment, may have seriously depressing effects upon investment in fixed capital. A depression may then well be the result, instead of a mild "correcting" recession;[2] and although the unsaturated demand for automobiles and houses may have a mitigating influence, large portions of that demand may cease to be effective.

[1] J. Steindle, "Post-War Employment in the U.S.A.," *Bulletin of the Oxford Institute of Statistics*, September 1944. Frederick C. Dirks and Ernest J. Hopkins, *Private Capital Requirements*, September 1946.

[2] There is a widespread belief that a mild recession would be welcome as a "corrective" to certain maladjustments which arose in the economy in the course of the post-war boom, and would lead to a solidly founded high employment level in the immediately coming years.

The possibility of recession or depression in the near future raises some problems of a more general nature. We are accustomed to the possibility of unemployment resulting from inadequate effective demand amidst sufficient resources to use all available labour productively. The present situation, however, is more complicated. The consumption of automobiles might be much greater if it were not for the fact that their output is hampered by a shortage of steel. Should car production expand, the aggregate effective demand would certainly be much higher. The inadequate supply of automobiles prevents the demand for them from materializing, and the unused purchasing power is not directed towards other commodities. A decline in general economic activity may thus materialize in spite of an excess of effective demand for particular goods. In the course of the recession the existing shortages may be eliminated through a fall in demand rather than through the expansion of supply.

It should be stressed that, just as in a "normal" depression, the situation described above arises on the basis of a given income distribution. Should profit margins be reduced, purchasing power for non-durable goods and services would rise and thus counteract the deflationary forces. Such a development, however, is hardly likely without specific and effective governmental measures directed to achieve this objective.

APPENDIX

Gross national product and disposable income

In order to estimate the gross national product in the second half of 1947 we shall divide it into four parts, as shown in table 8 (the last column shows the estimates for the second half of 1947 arrived at in the subsequent analysis).

As will be seen, the labour and proprietors' income increased from the fourth quarter of 1946 to the first half of 1947 by $3,300 million. The half-yearly rate of increase was thus $4,400 million.[1] On the basis of the July figures and recent developments in farm prices, we may expect a higher rate of increase from the first half to the second half of the year if the present level of employment is maintained. We put it tentatively at over $6,000 million, and thus assume that labour and proprietors' income will be $178,500 million per annum in the second half of the year. (It should be noted that an error in this item will affect relatively little the estimate of

[1] There are 4.5 months from the middle of the fourth quarter to the middle of the first half of the subsequent year. Thus, to obtain the half-yearly rate of increase $3,300 million must be multiplied by 6/4.5.

Table 8

ESTIMATE OF GROSS NATIONAL PRODUCT AT FULL EMPLOYMENT IN THE SECOND HALF OF 1947

	4th qtr. 1946 (annual rate)	1st half 1947 (ann'l rate)	2d half 1947 (ann'l rate) (hypothetical)
	(Thousand million dollars)		
Compensation of employees, proprietors and rental income[1]	168.9	172.2	178.5
Corporate profits before tax	27.1	29.0	31.0
Corporate inventory valuation adjustment	—8.3	—5.5	—1.5
Remaining gross national product[2]	30.9	29.3	30.0
Gross national product	218.6	225.0	236.0

[1] Wages, salaries, employer contributions for social insurance, other labour income, proprietors (business, professional and farmers) income, rental income.

[2] Capital consumption allowances, indirect taxes less subsidies, current surpluses of Government enterprises, interest, statistical discrepancy.

the deficiency in demand, for any change in personal income would be largely offset by the resulting increase in consumption.)

The corporate profits before tax in the first half of 1947 were $29,000 million per annum, and the appreciation of inventories $5,500 million, so that the corporate profits adjusted for inventory valuation were $23,500 million. We assume that the pricing policy of corporations, in the sense of profit margins added to costs, will be the same in the second as in the first half of the year.

There is, nevertheless, still a considerable difficulty in estimating the corporate profits in the second half of 1947. The appreciation of inventories in the second half of this year is likely to be substantially lower than in the first. We assume an appreciation of $3,500 million per annum as compared with $5,500 million in the first half of the year. Now, it may be shown that if business firms base their price calculations on the *purchase* cost of factors used in the production of goods sold during a given year, it is the profits unadjusted for changes in the valuation of inventories that are determined by pricing policies of the firms. In the case, however, when the calculation of prices is based not on the purchase cost of factors of production which entered into the goods sold in a given year, but on their *current* costs or cost of *re-purchase,* the pricing policies determine the level of

profits adjusted for changes in the valuation of inventories.[1] It is thus clear that our estimate of corporate profits in the second half of the year will largely depend on which of these two alternatives we take into consideration.

Some idea of which alternative should be taken into account can be derived from statistics of corporate profits unadjusted and adjusted for valuation of inventories given in table 9.

Table 9

CORPORATE AND INVENTORY VALUATION ADJUSTMENT

	Corporate profits before taxes	Inventory valuation adjustment	Adjusted corporate profits
1946		*(thousand million dollars)*	
First quarter	15.2	—1.0	14.2
Second quarter	19.4	—2.3	17.1
Third quarter	22.9	—7.3	15.6
Fourth quarter	27.1	—8.3	18.8
1947			
First half	29.0	—5.5	23.5

Source: Department of Commerce. The data for the first half of 1947 are taken from the *Midyear Economic Report of the President.*

It will be seen that it is rather the unadjusted than adjusted profits that follow the trend of corporate sales and pricing policy. Adjusted profits fell from the second to the third quarter of 1946 although corporate sales expanded at that time and profit margins were on the increase after decontrol; unadjusted profits show a substantial rise. From the fourth quarter of 1946 to the first half of 1947 adjusted profits jumped up from $18,800 million to $23,500 million which does not seem justified by the trend of business, while unadjusted profits show a much more likely moderate increase from $27,100 million to $29,000 million.

We therefore assume that the formation of unadjusted corporate profits in the second half of 1947 will be independent of inventory

[1] Let us denote by a the value of sales in a given year, by b' the cost involved in purchasing the factors of production used in manufacture of the goods sold and by b their current or re-purchase cost. The change in the valuation of inventories (if they are valued at purchase cost) will be $b - b'$ because, during the year, goods valued b' are taken out of inventories and goods valued b are added to them. Thus, profits (exclusive of those due to the increase in the *volume* of inventories) are:

$$P = (a - b) + (b - b') = a - b'$$

Now, if pricing is based on fixing $a - b'$, profits P are independent of changes in the valuation of inventories. They will be influenced by this factor, however, if the pricing policy is based on fixing $a - b$. Then it is only $P - (b - b')$, or profits adjusted for changes in valuation of inventories, that will be independent of changes in the valuation of inventories.

appreciation, and we estimate them at $31,000 million, i.e. higher than in the first half of 1947 in harmony with our assumption about the rise in labour and proprietor's income. Appreciation of inventories is estimated as mentioned above at $3,500 million per annum.

Finally, the remaining "gross national product", including capital consumption allowances, indirect taxes, interest, etc., was $29,300 million in the first half of 1947. The various items in question are likely to increase slightly, and we thus estimate the respective figure for the second half of the year at $30,000 million.[1]

The above discussion leads as shown in table 8, to an estimate of gross national product in the second half of 1947 at $236,000 million per annum on the assumption of maintenance of the present level of employment.

Table 10

RELATION OF GROSS NATIONAL PRODUCT AND DISPOSABLE INCOME

	1946	*1947* First half *(annual rate)*	*1947* Second half *(annual rate) (hypothetical)*
	(thousand million dollars)		
Gross national product	203.7	225.0	236.0
Less:			
Capital consumption allowances	11.0	11.8	12.0
Indirect taxes less subsidies plus contributions for social insurance, plus current surplus of Government enterprises	22.0	22.6	23.0
Corporate profits adjusted for inventory valuation	16.5	23.5	27.5
Plus:			
Government transfer payments	10.8	10.3	12.0[1]
Net interest paid by the Government	4.5	4.5	4.5
Dividends	5.6	6.2	7.0
Statistical discrepancy[2]	2.1	3.0	3.0
Equals:			
Personal income	177.2	191.1	200.0
Less:			
Personal tax and non-tax payments[3]	18.8	21.5	22.0
Equals:			
Disposable Income	158.4	169.6	178.0

[1] Inclusive of the anticipated cashing of veterans' terminal leave bonds.
[2] To reconcile with the estimate of personal income based on income data.
[3] Net of tax refunds.
Source: Department of Commerce. The data for the first half of 1947 are taken from the *Midyear Economic Report of the President.*

[1] The statistical discrepancy between income data and expenditure data included in the item is assumed to be unchanged.

In table 10 the derivation of disposable income from gross national product is shown for 1946, the first half of 1947 and the second half of 1947 (in the latter on the assumption of the maintenance of the present level of employment).

The figure for adjusted corporate profits for the second half of 1947 corresponds to our estimate of corporate profits and inventory valuation adjustment as shown in table 8. Except for transfers, the other items accounting for the difference between gross national product and disposable income are changed little in the hypothetical calculation for the second half of 1947 as compared with the first half of the year. Transfers are increased mainly by inclusion of the anticipated cashing of veterans' leave bonds.[1]

[1] The statistical discrepancy between income and expenditure estimates is assumed unchanged in accordance with the footnote to page 21.

PART II

SCARCITIES AND INFLATIONARY PRESSURES IN DEVASTATED EUROPE

1. *The United Kingdom*

In the United Kingdom, as in all European countries, there is no question of the adequacy of domestic demand in the near future for the potential output of the country. Production and employment are limited only by the availability of labour, materials, plant and equipment.

The major problem of such countries is to keep demand sufficiently in check and to raise output in order to prevent inflation and to provide for a steadily rising standard of living. The problem is complicated by the fact that imports of food and raw materials are generally necessary to sustain the economy, and the countries are as yet unable to export in sufficient quantity, particularly to countries with net exports, in order to pay for their imports.

In this respect, the United Kingdom has fared better than most of Europe. It suffered less war devastation than did continental Europe. Although it had to curtail consumption during the war in order to release resources for war purposes, it did so without incurring any serious inflation. Since the end of the war, it has succeeded in reconverting the economy to peace production without incurring any significant unemployment, and its output has risen above the pre-war level. Unlike the United States of America, it has retained the wartime system of anti-inflationary controls and has thus prevented prices from rising rapidly even in the post-war period.

Despite this achievement the United Kingdom is in an extremely difficult economic position in 1947. It has already suffered from a coal crisis early in the year, and it is now suffering from a crisis in foreign exchange which must be overcome rapidly if the economy is to be maintained at a satisfactory rate.

To understand the basic problems of the British economy in 1947, it will be useful first to review briefly the situation in 1946.

SECTION 1. THE ECONOMIC SITUATION IN 1946

The intense pressure of post-war demand and the dislocation of the war made the labour force sufficiently mobile in 1946 to absorb the shock of a large-scale change in the structure of production without creating any significant unemployment. Although about one-third of

the labour force had to be released from employment for military purposes, unemployment in December 1946 amounted to only two per cent of the labour force.

There are no official over-all data on the physical volume of output. Such data as do exist, however, suggest that, as conventionally measured, the gross national product in constant prices was higher in 1946 than in 1938,[1] but that most of the increase was used for government purposes. Gross capital formation at home was still below 1938,[2] despite the wartime deterioration of plant and equipment, and total private consumption in constant prices was about the same as in 1938.[3]

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[1] The London *Economist*, 19 April 1947, has roughly calculated that the gross national product in 1938 prices was about one-sixth higher in 1946 than in 1938. This estimate appears to be excessive.

A more precise estimate was made by T. Barna in collaboration with E. A. G. Robinson and C. F. Carter, *The Economic Position of the United Kingdom in 1947*, London and Cambridge Economic Service, 12 May 1947. Their estimate is that the gross national product in constant prices was ten per cent higher in 1946 than in 1938, and that the total output of industry (excluding rent, income from abroad, and income produced in Government), was about five per cent above 1938.

[2] The White Paper on National Income (Cmd. 7099) estimated that *fixed* gross capital formation in 1946 was roughly two-thirds of the 1938 level. Barna estimates that inventory accumulation must have been slightly negative in 1938, but positive and fairly large in 1946. He concludes that *total* gross capital formation in 1946 was about fifteen per cent below 1938 in constant prices.

[3] Consumer expenditure is the only major national income component for which official estimates exist in constant prices. Revaluing the quantity of each consumer good and service actually bought at its 1938 price, the National Income White Paper estimated that in 1946 consumer expenditure, measured in 1938 prices, was about ten per cent above 1945 and about one per cent above 1938.

The general impression that consumption in the United Kingdom is considerably below pre-war is based largely on the changes in the composition and distribution of consumption, discussed later in the text. Consumers short on food, clothing and household furnishings do not feel compensated in being able to secure more liquor, tobacco and entertainment. The middle and upper groups, whose consumption has fallen, do not feel compensated by the rise in consumption of the lower income groups. Consumers hoped that with the end of the war, the supply of food, clothing and household furnishings would be more nearly adequate to satisfy the intense demand than it has in fact been. In the light of these factors, it is easy to reconcile the popular impression of sharply reduced consumption with the White Paper estimate that total consumption in 1938 prices was as high as before the war.

It may be noted that this estimate does not in itself necessarily mean that the British are as well off as before the war. The use of consumption figures even in constant prices to measure changes in welfare is always subject to serious limitations. When, as was true in 1946, there are serious shortages of many commodities and people are forced to change their normal expenditure patterns, the difficulties are overwhelming.

The estimate must be qualified even on the purely physical level as a measure of the change in the total volume of goods and services produced. For the available data do not fully take into account changes in quality of goods and services, most of which were downward. They also do not take into account the elimination of many services such as packaging and delivery, or the increase in time and effort required for shopping.

The shares of government expenditure, gross capital formation at home and consumption in the money value of the national resources available for use at home (equals gross national product plus net imports) is shown in the table below.

Table 11

ALLOCATION OF THE TOTAL RESOURCES AT HOME BETWEEN DIFFERENT USES

	1938	*1945*	*1946*
		(per cent)	
Personal consumption	71	49	60
Government current expenditure	15	44	25
Gross non-war government and private capital formation	15	7	14
Gross resources used at home	100	100	100

Note: Detail will not add to total, because of rounding.
Source: Based on Cmd. 7099.

Although the total supply of consumption goods and services was about as high as before the war, it was still necessary to retain the rigorous wartime system of controls to prevent inflation. Uncontrolled demand would have been substantially in excess of the available supply.

On the supply side the increase was exceedingly uneven. Consumption of liquor, tobacco, reading material and entertainment was considerably higher than before the war. The basic consumption goods, however – food, clothing and household items – were all in shorter supply as a result of world shortages, insufficiency of foreign exchange, and lack of manpower for relatively low paid industries. The decline in total food consumption was slight, but here too the changes in the components were considerable. Consumption of bread and cereals, potatoes and milk was greater, but that of meat, fats, sugar and fruits was considerably below pre-war. These changes in the consumption pattern were enforced rather than voluntary. In the absence of price and rationing controls, the prices of many basic consumption goods would have risen very sharply even if total demand had been no higher than before the war.

The pressure of demand, however, was in fact considerably above the pre-war level. First, there was (and still is) a very large accumulation of deferred demand as a result of six years of wartime shortages in clothing, household furnishings and durable goods. This demand was supported by the large volume of accumulated wartime savings. Second, the demobilization of the armed forces and the rise in the number of families added a further strain on civilian markets.

Third, as a result of changes in taxation, there was a change in the distribution of income in favour of the lower income groups, which increased the total demand out of the given income.[1]

These factors reduced the tendency to save, whereas the savings required to offset the government deficit and capital formation rose slightly from nearly eight per cent of private income after taxes in 1938 to ten per cent in 1946. The over-all inflationary pressure, therefore, remained very strong.

To balance demand and supply the United Kingdom has relied on her wartime system of rationing and controls on production and prices. Allocation controls serve to ration scarce raw material supplies. Production controls on consumption goods such as clothing, shoes and furniture prohibit the output of many luxury items and concentrate output on utility goods.[2] Essential consumption goods in short supply are strictly rationed[3] and sold at controlled prices. Prices of mass con-

[1] This change in distribution is evident from the following table:

PRIVATE INCOME AFTER PAYMENTS OF DIRECT TAX BY TYPE

	1938	*1946*	*Increase 1938 to 1946*
	(Millions of pounds)		*(per cent)*
A. Lower income groups:			
1. Wages*	1,682	2,720	62
2. Pay and allowances of the armed forces	77	502	552
3. Social security benefits and other transfer incomes	270	737	173
Total (1 + 2 + 3)	*2,029*	*3,959*	*95*
B. Middle and upper income groups:			
4. Salaries	1,054	1,408	34
5. Rent, interest and profits†	1,508	1,938	29
Total (4 + 5)	*2,562*	*3,346*	*31*

Source: Cmd. 7099. Based on table 8, page 11, and table 35, pages 58-59.

* Direct taxes on wages include employees' national insurance contributions.

† Including farmers' profits and professional earnings.

Note: Total payments of direct tax exclude income tax repayable as post-war credit. Because the White Paper data are insufficiently detailed to permit the allocation of the repayable portion to the separate income groups, the entire amount was deducted from taxes paid on rent, interest and profits. The table therefore understates direct tax paid by this category and correspondingly overstates the amount paid by the other categories.

[2] Approximately eighty per cent of the clothing output is within the utility scheme. Working Party Reports, *Heavy Clothing*, London, H.M. Stationery Office, 1947, p. 16.

[3] The rations set by the Government are, of course, much lower than the pre-war average *per capita* consumption of the middle and upper income groups, but for many items they are probably in excess of the pre-war average *per capita* consumption of the lower income groups.

sumption items have on the whole been prevented from rising in price as much as other items. Subsidies have been employed extensively to absorb increases in costs of production or importation of basic commodities.[1] Some consumption goods are subject to price control even though they are not rationed. Where the goods are in short supply the failure to ration results in haphazard distribution.

These controls were adequate to prevent large-scale price increases. They were not sufficient, however, to prevent depletion of inventories of basic materials which were used up very rapidly by full-employment operations. For some commodities stricter allocations would probably have prevented inventory depletion, but for others like coal, direct inventory controls would have been necessary. These were not employed, and, as a result, inventories of coal, wood, steel, etc., diminished very dangerously. The stage was thus set for the crisis in coal supplies early in 1947 which upset the entire production time-table.

Table 12

UNITED KINGDOM STOCKS: NUMBER OF WEEKS' STOCKS AT CONSUMPTION RATE OF CURRENT CALENDAR YEAR

31 December	*Coal*	*Soft wood*	*Hard wood*	*Steel*[1]	*Refined lead*	*Bricks*[2]
1942	5.7	24	16	8.9	18.1	n.a.
1943	6.0	39	19	8.6	29.6	n.a.
1944	5.8	23	23	7.2	32.0	n.a.
1945	4.5	37	24	5.4	14.4	38
1946	2.9	10	12	4.4	5.8	3.4

[1] Number of weeks' production of ingots.

[2] Consumption rate estimated at production rate plus rate of fall in stocks.

Source: D. G. Champernowne, "Critique of the Economic Survey", *Oxford University Institute of Statistics Bulletin,* March-April 1947, based on *Monthly Digest of Statistics.*

SECTION 2. PROBLEMS AND PROSPECTS

A. *The national income goal*

Prior to the coal crisis, the British plan for 1947 called for an increase of about nine per cent or about £700 million in the national income in current prices.[1] Since military payrolls are declining, the increase in the net output of enterprise would be even larger. This would have permitted a substantial planned increase in housing (240,000 permanent houses to be completed in 1947 compared with 60,000 in 1946) and in plant and equipment (fifteen per cent above

[1] The inflationary effect on purchasing power through the government budget is not serious because rationing is used to balance demand and supply.

pre-war investment) and a small further improvement in consumption. Progress was made in many directions, but the time-table was upset by the coal crisis and may now be further upset by the crisis in foreign exchange.

To increase its national income the United Kingdom has to increase manpower available for private employment, improve output per man-hour, and increase the supplies of key commodities to industry.

Increased manpower for industry can come only through a reduction in government employment, or through an increase in the size of the labour force.[1]

In view of the retention of price and rationing control and the demands of government planning there is little prospect of a reduction in the size of civilian government employment. The programme for reductions in defence expenditure which the Government is now accelerating will, however, release men both from the armed forces and from war industries for civilian production. The increase in the size of the total labour force will be very small, since there is very little prospect of attracting once again the housewives and others who swelled the labour force abnormally during the war, and since the recruitment of labour abroad is on a very small scale.

There is no official index of the output per man-hour for the economy as a whole.[2] Several critical industries such as coal mining and building have suffered substantial declines in average output per man. In other industries, and especially in agriculture, average output per man is higher than before the war. Many things can be done to increase output per man even under present economic conditions, but sharp increases in productivity cannot be expected before sufficient new plant and machinery are available. In the meantime, attention is being concentrated on the obstacles to increased productivity in certain critical industries, particularly coal and building.

In addition to increased manpower and productivity, the United Kingdom needs larger supplies of food and basic materials. In part, the problem is one of increasing production in the United Kingdom. This is especially true of coal. In part, however, the problem is one of securing a larger volume of imports. Some imports cannot be sig-

[1] The Government is also concerned with improving the distribution of manpower between industries.

[2] The estimate presented above of the rise in the output of enterprise as conventionally measured, when taken in conjunction with the decline in private employment, implies a rise in average output per man. As has already been noted, however, the estimate of output in constant prices is somewhat artificial. Apart from this factor, the estimated rise in output per man is in large part attributable not to a rise in productivity within industries, but to a shift in employment from the service and consumption goods industries, where the value added per man-hour is low, to the chemical and engineering industries, where it is high.

nificantly increased because of world shortages of supply. The more basic problem for the United Kingdom, however, is its inability to finance additional imports with sufficient exports or with borrowings.

The most critical material in short supply is coal. Although the production of coal in 1946 was only about four-fifths of the pre-war level, inland coal consumption was actually higher than in 1938, because of the high level of national income and the excessive consumption of coal by antiquated equipment. The high level of coal consumption in the face of decreased production led to almost complete cessation of exports and a sharp decline in inventories. Although the loss of exports is itself a serious problem for the United Kingdom, it was completely dwarfed by the economic loss resulting from the reduction in inventories. For when winter snows tied up coal transportation for a few weeks in 1947, British industry had inadequate inventory reserves on which to rely and was forced to curtail operations drastically. About one and a half million persons had to be laid off as a result of the coal crisis in February.

Table 13

PRODUCTION, CONSUMPTION AND STOCKS OF COAL, 1938–1946

	Production	Inland consumption	Exports	Distributed stocks (end of year)
		(*Thousands of tons*)		
	(Weekly average)			
1938	4,353	3,463	890	
1939	4,437	3,543	894	14,550
1945	3,506	3,440	157	12,442
1946	3,632	3,567	168	8,466

Source: *Monthly Digest of Statistics,* March 1947.

To provide sufficient coal for its production programme the United Kingdom has introduced various measures to conserve the use of coal, giving high priority to conversion to oil-burning and to production of electric power, and limiting industrial and domestic consumption of coal.[1] In addition, it has set a coal production goal for 1947 of 200 million tons, six per cent more than in 1946 but about twelve per cent less than in 1938. This goal calls for a significant increase in employment and in output per man in coal mining, especially in the light of the recent reduction of the work week to five days.[2]

[1] Direct burning of coal in homes has decreased substantially since 1938, but the decline has been largely offset by a great increase in the indirect consumption of coal through the use of electricity. This increase was greatly facilitated by the large volume of electrical appliances produced in 1946.

[2] The Government is now asking the coal miners to work an additional half hour every day at time and a half in order to increase coal production.

If the production and conservation measures should prove to be inadequate, the United Kingdom will be compelled to look for coal imports from South Africa, Poland and the United States in order to sustain her national production. The small additional coal imports that might be required would not add greatly to the foreign exchange requirements, provided that the United Kingdom would itself ship the coal. It may be difficult, however, for the exporting countries to increase their total volume of coal exports.

Next to coal, the most important shortages are in food and housing.[1] Under the stimulus of the war, Britain mechanized her agriculture and increased her net agricultural output by about thirty-five per cent in terms of value at constant prices and by about seventy per cent in terms of calories. This increased food production is essential both to feed the population and to conserve British foreign exchange. The Government is now attempting to shift production from cereals, which are relatively more abundant in Britain, to livestock products, which are extremely scarce. Such a policy would also result in considerable savings of foreign exchange. It is, however, being delayed by the world shortage of cereals.

The floods which followed the severe winter snows early in 1947 have severely damaged livestock and food crops in Great Britain. Food supplies in 1947 may therefore be less than in 1946, especially since the United Kingdom has difficulties in paying for its imports. Rations have already been reduced, and may have to be reduced even more, perhaps on a differential basis.

Output in the building industry in 1946 was still below pre-war levels. Employment was nearly as high as before the war, but output per man-year was considerably lower. For 1947, the Government originally planned to build 240,000 permanent homes and 60,000 temporary houses, compared with over 350,000 permanent dwellings built in 1938. The shortage of timber has, however, led to curtailment of the plan. Additional timber might be available from Sweden if the latter could obtain additional supplies of coal from abroad. Negotiations with the Union of Soviet Socialist Republics for additional timber as well as food in exchange for machinery and other goods have been discontinued.

B. *The balance of payments*

The major obstacle to an increase in imports of basic materials is the lack of foreign exchange. The deficit in the balance of payments, especially with the dollar area, is the most critical problem with which the United Kingdom is confronted today.

[1] The supplies of several other basic materials and services, especially steel, power and transportation, need to be increased substantially to avoid bottlenecks in total production.

Immediately after the end of the war, the United Kingdom engaged in a vigorous campaign to increase her exports. By the end of 1946 her exports had more than doubled in volume, rising from forty-six per cent of the 1938 level in the third quarter of 1945 to a hundred and eleven per cent in the fourth quarter of 1946. Despite the cessation of lend-lease, her commercial imports rose only moderately in the same period, from sixty-two per cent of the 1938 volume to seventy-two per cent. As a result of this programme, the deficit in the trade balance of 1946 was actually less than in 1938 by £82 million. This improvement in the trade balance, however, was insufficient to offset the increase of £128 million in the deficit in the balance of invisibles — interest, profits, dividends, shipping and the like. The item which raised the deficit most was the increase of £284 million in Government expenditure abroad for military, relief and rehabilitation purposes.

Table 14

BALANCE OF PAYMENTS IN 1938 AND 1946

	1938	1946	Increase or decrease 1938–1946
Balance in:		*(Millions of pounds)*	
Commodity trade	—302	—220	82
Invisibles	248	120	—128
Government expenditure	— 16	—300	—284
Total payments	— 70	—400	—330

Source: Based on Cmd. 7099.

The Economic Survey for 1947 set an import goal amounting to 80–85 per cent of the 1938 volume. Making an allowance for an increase in prices over 1946, the Government estimated that the goal involves £1,450 million in imports. The export goal amounted to 140 per cent of the 1938 volume by the end of 1947 or about 125 per cent as the average for the year. After allowing for the higher price level in 1947, exports for the year would amount to £1,200 million. The deficit in the trade balance would therefore be £250 million, about £30 million more than in 1946. Government expenditure abroad was expected to fall about £125 million, and net receipts from invisibles to rise about £25 million. Under this goal, the deficit in the balance of payments would be reduced to about £280 million.[1]

[1] The Economic Survey for 1947 estimated that the deficit would be £350 million rather than £280 million. This projection, however, was based on the estimate that the net balance of invisibles would rise from £50 million in 1946 to £75 million in 1947. Since the White Paper on National Income, Cmd. 7099, raised the estimate of the net balance on invisibles in 1946 by £70 million we have raised the projected balance on invisibles and reduced the projected total deficit for 1947 by the same amount.

Table 15

CURRENT BALANCE OF PAYMENTS 1946 AND GOAL FOR 1947

	1946	1947	Increase or decrease 1946–1947
Balance in:		(*Millions of pounds*)	
Commodity trade	—220	—250	—30
Invisibles	120	145	25
Government expenditure	—300	—175	125
Total current payments	—400	—280	120

Source: Based on projections in Economic Survey for 1947 and on Cmd. 7099.

Developments since the publication of the Economic Survey indicate that the deficit in the balance of payments will be larger than had been anticipated. Largely as a result of the coal crisis, exports have failed to rise as rapidly as had been anticipated. Imports, on the other hand, have risen more than was planned, largely because of the sharp rise in prices in the United States.

Within the total balance of payments problem there is the critical dollar problem. Most of the United Kingdom deficit is with the United States and other countries of the Western Hemisphere. This deficit is incurred in dollars. The Economic Survey for 1947 estimated that the United Kingdom buys forty-two per cent of her imports from this area and sells only fourteen per cent of her exports there.

With many countries of the Eastern Hemisphere the United Kingdom has in fact an export surplus. If these countries could supply her with a larger portion of her import needs, her dollar deficit could be reduced. Alternatively, if they had or could secure gold or dollars through increased exports to or loans from the Western Hemisphere, the United Kingdom could obtain dollars from them. These countries, however, at present lack the goods or the gold or the dollars with which to pay for their net imports. Thus the United Kingdom is taking payment for its net exports either through increasing its holdings of currencies which are not at present convertible into dollars or by reducing its debt to the countries involved. To this extent its exports do not currently contribute to the solution of its foreign exchange problem.

The dollar problem has been aggravated by two factors relating to the United States loan. The first is the anti-discrimination clause which prohibits the United Kingdom from discriminating against imports from the United States in favour of those from other countries. As a result the United Kingdom may not buy goods in other countries if they are available at a lower price in the United States. The United States has recently agreed to a relaxation of the rules to permit discrimination in favour of British colonies and has discussed with the United Kingdom additional measures of relaxation.

The second factor was the free convertibility into dollars of all current sterling balances after the middle of 1947[1] which had to be suspended in August 1947.

It was originally believed that free convertibility would not be a grave problem because the countries which lacked dollars did not have substantial net exports to the United Kingdom which they might convert into dollars. It was, however, the gross receipts from the United Kingdom and not the net balances which were legally convertible into dollars. Even countries which had been incurring deficits with the United Kingdom could therefore shift a part of their purchasing from the United Kingdom to the dollar countries[2] or they could even accumulate dollar reserves for future use, thereby depleting the dollar reserves of the United Kingdom. In either event exports of the United Kingdom might be curtailed.

Free convertibility of current balances may even have made it more difficult for the United Kingdom to keep the accumulated balances frozen. A large part of the accumulated balances was kept frozen by a "gentlemen's agreement" not to convert. So long as no sterling was freely convertible it was easy to detect cases of circumvention of this agreement. Once current balances became freely convertible, however, detection of violations became more difficult. Moreover, the rapid depletion of the United Kingdom's dollar resources probably generated lack of confidence with respect to the duration of free convertibility and thus stimulated conversions of both current and accumulated balances.

To meet its mounting dollar deficit the United Kingdom has had to use up nearly all the United States loan in little more than one year. The rate of withdrawal has been much more rapid throughout the year than had been originally anticipated, largely as a result of the rise in the United States prices. It was recently accelerated very sharply, however, with the introduction of free convertibility. As a result, the United Kingdom has recently suspended free convertibility of current balances, and further drawings on the United States loan have been postponed. Its imports from the United States and other hard currency countries may thus be forced down in the near future.

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[1] Free convertibility did not apply to accumulated balances. During the past year, however, the United Kingdom negotiated a series of agreements with a number of countries, particularly with Argentina, Egypt and India, to permit the conversion of approximately £100 million of accumulated sterling balances into dollars. Although this is a small fraction of the total balances, it represented a substantial drain during this period on the dollar resources of the United Kingdom. Doubtless an effort will be made to repay as much as possible of the remaining accumulated debt in goods and services rather than in dollars.

[2] The remarkable increase in United States exports, particularly of finished manufactures during the first half of 1947 demonstrates both the intensity of the foreign needs and the large export capacity of the United States.

To meet the basic problem of the balance of payments, the United Kingdom is attempting not only to retard the present rate of growth of imports, but also to step up the rate of export. While at present it may not be difficult for the United Kingdom to increase its exports to the non-dollar areas which are short of all types of finished manufactured goods, it may be quite difficult to do so to the dollar areas. Only a few industries such as high-quality textiles and china can compete effectively with United States industry in the United States market. These United Kingdom industries are already exporting at capacity rates. Expansion of exports to other dollar areas such as Latin America is difficult either because of United States competition or because the goods are essential for reconstruction at home.

It may be possible for the United Kingdom to continue for some time longer to incur dollar deficits in its balance of payments by drawing on the Canadian loan and on its gold reserves and by further sale of its external assets. The extent to which this may be done is, however, quite limited. The United Kingdom may thus have to solve its deficit problem by reducing its imports from the dollar areas, and by establishing closer trade ties with the non-dollar areas to provide it with additional food and raw materials in exchange for its manufactured products.

2. *France*

Section 1. The economic situation after the liberation

The main characteristics of the French economic situation immediately after the Liberation were as follows.

1. Industrial and agricultural production were at a very low level. As a result of the general dislocation caused by hostilities, French industrial production in the first half of 1945 was about thirty-five per cent of the pre-war level. The main causes for this low level were the general disruption of all transport and the lack of coal. Only about one-sixth of the pre-war number of locomotives and one-fourth of the pre-war number of freight-cars were serviceable; more than one-third of the trucks were lost; two-thirds of the ports and of the merchant shipping tonnage were destroyed. Coal production had fallen to about sixty per cent of pre-war. While output was raised shortly after the Liberation as a result of vigorous efforts by the French Government, coal imports, which before the war represented one-third of French consumption, remained at very low levels.

Industrial production also suffered from lack of raw materials and of equipment. Imports of raw materials were limited by world shortages of both materials and shipping. Much industrial equipment in France

had been destroyed and the rest had been allowed to deteriorate through six years of wear and tear without adequate maintenance.

Agricultural production in 1945 was about sixty per cent of the pre-war level. The area under cultivation had been reduced by twenty per cent, and an eighty per cent drop in fertilizers reduced yields per acre. The livestock population was greatly reduced — fifteen per cent of the cattle and about half of the pigs were lost.

In the first half of 1945, the so-called "Index of global resources" which represents production plus the net imports in agriculture and industry, was little more than half the pre-war level. Such a set-back could of course be overcome only gradually.

2. During the occupation, the Germans had introduced a fairly comprehensive rationing system, embracing most of the essential commodities, based on compulsory deliveries of food and on control of industry. However, this system was not comprehensive in the sense of mobilizing the total supplies of the commodities in question, and there was always a substantial black market. Owing to the general dislocation caused by hostilities, and in particular to the reduction in supplies, rationing and controls were considerably loosened during the Liberation. The index of controlled prices in December 1944 was about three times as high as before the war (shown in table 16 below); but as is indicated by the existence of an extensive black market, a genuine price index would have been considerably higher. This point will be considered in detail below.

3. The index of hourly real wages in terms of controlled prices stood at eighty-two per cent in relation to the pre-war level in October 1944, and at ninety-five per cent in April 1945 (see table 21 below). These indices, however, greatly overstate the purchasing power of wages, since even the workers purchased a considerable part of their needs on the black market.

4. Throughout the occupation, the budget deficit, including as a major part the cost of the German occupation, was very large. As a counterpart of this deficit and of the partially effective rationing system, there was a considerable accumulation of liquid savings. This found its expression in a very large increase in the quantity of money. Circulation of notes in December 1944 was about five times as high as in 1938. The total quantity of money, including savings accounts and deposits, increased in about the same proportion. The public debt as a whole increased from 420,000 million francs at the end of 1938 to 1,680,000 million francs at the end of 1944.

5. Immediately after the Liberation, there was a considerable budget deficit, while the net imports — an offsetting factor — were very small.

6. Supplies available for consumption were further reduced below the level shown by the production indices by a tendency to hoard on the part of producers and middlemen. This hoarding tendency was induced by an inflationary psychology, a general expectation that both controlled and black market prices were bound to rise.

Section 2. The major economic trends, 1945-46

It has already been mentioned above that a considerable black market existed, owing to the looseness of controls. From the figures quoted above, it is quite clear that prices at the black market had to be much higher than the official level.

The physical volume of supplies at the beginning of 1945 was equal to only about half the pre-war volume, and official prices had trebled. If the official prices had been accurate, the total value of available supplies would have equalled about one and a half times the value of supplies available before the war. Since the quantity of money was nearly five times as large as in 1938, the excess over the increase in the value of supplies would signify a large pent-up demand in terms of liquid savings. Moreover, the budget deficit would be a large proportion of the national income, while real wages would be high in relation to supply conditions.

Such a situation would be tenable only if a strictly enforced control and rationing system on the English model were in operation. But, as stated above, this was not the case. Only a part of the supplies went into the rationing system, while the rest was distributed in the black market.

The controls were fairly effective for producer goods, but less so for industrial consumption goods and for most agricultural products. Raw materials for industry were allocated, and investment goods were sold on a licence system. Durable consumption goods, which were produced in very small quantities on the basis of government allocations, were sold on certification of need. Non-durable consumption goods such as clothing and shoes, which were produced in relatively larger quantities, were rationed. For such goods leakages into the black market were fairly important, and even a portion of the rationed supplies were sold in excess of the controlled prices. For agricultural products prices were fixed by the Government at all levels from the farmer to the retailer, but the price controls were effective only where the procurement was effective. The controls worked best on bread, since all wheat procurement was in the hands of the Government. Even here there was an important loophole, however, as peasants were able to divert part of their crop to feed. For meat, dairy products and eggs, the controls worked very poorly. Although a Government procure-

ment office existed, the peasants hoarded much livestock, and a considerable part of the sales were made on the black market.

The black markets for agricultural products were so widespread that despite the rationing system the average level of actual prices was considerably in excess of controlled prices. The level was, however, probably lower than it would have been in the absence of rationing.[1] The rations served an especially useful purpose in mitigating the effects of the inflation on the lower income groups. Since the rations constituted a larger proportion of the consumption of the lower than of the upper income groups, they prevented the distribution of real income from changing against the lower income groups as much as would otherwise have been the case.

Two policies were envisaged at that time by the French Government. One was the introduction of a rigid system of controls and rationing. The second policy, which was not a full alternative to the first, but which would have coped at least with the problem of pent-up demand, was the blocking and subsequent destruction of a large part of the available liquid resources, as was done in Belgium, Poland, Yugoslavia, etc. Neither policy was adopted, however, and a course was taken which consisted in (*a*) the retention of the existing system of partial controls and rationing and (*b*) a gradual increase in controlled prices, followed in 1946 by freeing of prices or by the establishment in some cases of two sets of legal prices: controlled prices for rationed supplies and free prices for non-rationed supplies.

The readjustments in controlled prices and the first decontrols were immediately reflected in the official price indices. In August 1946, retail prices reached about 730 (580 in July), and the wholesale price index for foodstuffs reached about 710 (480 in July). For the first time since the Liberation, price indices began to reflect the actual prices of transactions and the black market shrank very considerably. The relaxation of controls, however, did raise the actual average level of prices, and it reduced the protection which rationing had provided to the lower income groups.

In the meantime, there was a considerable improvement in food and other supplies. French recovery since the Liberation has been remarkable. Agricultural production in 1946 was about eighty per cent of the pre-war level, and industrial production at the end of 1946

[1] If consumers had attempted to keep their money value of expenditures unchanged despite partial ration controls, unrationed prices would have risen so high as to keep the average level of agricultural prices and the average return to the farmers as high under partial ration controls as under a completely free market. This is probably an extreme assumption, however. It is much more likely that some portion of the money saved on rationed items was actually kept away from the market.

Table 16

INDICES OF PRICES IN FRANCE

Period	Wholesale prices [1] 1938 weights	Cost of living [2] Paris
	1938 = 100	
1944		
Fourth quarter	271	299
1945		
First quarter	284	315
Second "	356	358
Third "	400	419
Fourth "	459	482
1946		
First quarter	505	484
Second "	596	538
Third "	665	697
October	822	858
November	804	856
December	842	865
1947		
January	867	856
February	882	858
March	860	838
April	847	837
May	916	886

[1] 23 food products, 50 raw materials and 72 semi-finished products. For earlier figures, see *Etudes et Conjoncture,* No. 5-6, page 290. Quarterly data represent averages of monthly indices.

[2] 34 commodities inclusive of gas and electricity. The index does not include rent, which rose only slightly after the beginning of the war. Rents, however, were less than seven per cent of the cost of living before the war, so that failure to include them does not introduce any great error. For the method of establishing this index and for earlier figures, see *Bulletin de la Statistique générale de la France,* February-March 1946, page 70. Quarterly data represent averages of monthly indices.

Source: *Bulletin de la Statistique générale de la France. Etudes et Conjoncture.*

was back to ninety per cent. Key factors in the recovery were the rise in coal production, which reached 109 per cent;[1] in electric power, which rose to 119 per cent; and in railroad traffic, which reached 110 per cent of the pre-war level. Another necessary condition of the recovery which took place was an increasing supply of imported raw materials obtained and financed by exports and by means of foreign credits and sales of gold.

[1] France is the only European country affected by the war which has succeeded in mining more coal than before the war. Its output is partly based on the employment of German prisoners of war. Coal is scarce nevertheless, because imports reached only about five million tons in 1945 and about eleven million in 1946, compared with twenty-one million in 1938.

Table 17

RESOURCES OF THE FRENCH ECONOMY

Period	Agricultural Production[1]	Industrial Production[2]	Global Resources[3]
	1938 = 100		
1941	74	62	67
1942	75	56	60
1943	77	51	57
1944			
First quarter	77	53	60
Second "		42	48
Third "		20	41
Fourth "		30	51
1945			
First quarter	62	32	54
Second "		39	58
Third "		47	69
Fourth "		63	74
1946			
First quarter	79	70	82
Second "		83	89
Third "		81	90
Fourth "		90	90

[1] Net vegetable and animal production for human consumption. Data relate to crop years.

[2] Indices calculated on the basis of new series started in August 1945. Yearly and quarterly data represent averages of monthly indices.

[3] Includes French agricultural and industrial production and net imports of agricultural and industrial products. Quarterly data relate to final months of each quarter. Yearly data represent averages of quarterly data.

Source: *Etudes et Conjoncture* No. 1-2, page 110, and No. 5-6, pages 68, 83 and 302; Institut national de la Statistique et des Etudes économiques.

The level and composition of the available national resources in France in 1946 and 1938 are shown in the table on the next page.

For the year 1946 as a whole the gross national product in 1938 prices was about fifteen per cent below 1938. The net imports in 1938 prices, however, were nearly three times as high as in 1938, so that the gross resources available for use at home were about twelve per cent below 1938. Government expenditures and gross capital formation in 1938 prices were higher than in 1938. Consequently, the decline in consumption was considerably greater than in gross resources available for home use. The decline was especially serious in food, amounting to more than twenty-five per cent, compared with a decline of only twelve per cent in non-food consumption. As may be expected, black market activities and price inflation were most serious in the food sector of the economy.

Table 18

AVAILABLE NATIONAL RESOURCES 1938 AND 1946

(Thousand million francs in 1938 prices)

	1938	*1946*
A. Gross national product	425	359
B. + Imports	46	39
C. — Exports (tourism and freight)	38	16
D. National resources	433	382
E. Gross product of government services	25	36
1. Food	160	117
2. Other non-durable goods	86	84
3. Rent	25	22
4. Clothing, textiles and leathers	41	32
5. Other durable goods	28	21
F. Total consumer goods	340	276
6. Mechanical equipment	21	23
7. Transport material	12	18
8. Building and public works	25	24
9. Armament	10	5
G. Total equipment	68	70
D. National resources	433	382

Source: *Revenu national français*, page 32.

The increase in the volume of supplies, together with the rapid rise in official prices, was sufficient by the end of 1946 to restore the pre-war ratio between the money value of supplies and the total quantity of money. This fact may perhaps be interpreted as a crude indication[1] of the elimination of pent-up demand in the form of excess liquid savings accumulated during the war. It cannot, however, be interpreted as an indication of the solution of the basic problem of inflationary pressure.

The basic inflationary pressure in France arises from the fact that the requirements for savings have increased above the pre-war level, whereas the tendency to save has been reduced.

The decline in real income, especially in terms of food and other necessities, which was referred to above, has reduced the tendency to save. The desire to restore the consumer stocks of durable and

[1] It is an even cruder indication than would otherwise be the case, because peasants previously tended to save in the form of increased cash holdings, whereas under the inflationary pressures they tended to spend or invest in goods.

Table 19

QUANTITY OF MONEY AND VALUE OF GLOBAL RESOURCES

Period	Note circulation (End of month) (1)	Total quantity of money (2)	Total quantity of money index (3)	Index of value of global resources at official prices (4)	Ratio (5) : (4) (5)
	(Thousand million francs)			*(1938 = 100)*	
1938, end of year	111	177	100	100	100
1944					
September	625	902	510	—	—
December	572	855	483	148	326
1945					
February	569	840	475	165*a*	288
May	549	902	510	223*b*	229
August	470	876	495	304*c*	163
December	570	1,043	589	356	165
1946					
February	605	1,096	619	426*d*	145
May	626	1,164	658	526*e*	125
August	633	1,212	685	680*f*	101
November	705	1,332	753	767*g*	98
1947					
January	730	—	—	—	—
February	737	—	—	—	—
March	746	—	—	—	—

Note. The note circulation fell after Liberation as a result mostly of the subscription to the Liberation Loan and of the note exchange which took place in 1945. (A fraction of the notes were not presented for exchange.)

Col. (1) Source: *Bulletin de la Statistique générale de la France.* Col. (2) Source: *Etudes et Conjoncture* No. 5-6, page 143. Total quantity of money includes note circulation, bank deposits and postal checks. Col. (3) is derived from col. (2). (4) Value of global resources = volume of global resources multiplied by average of wholesale and retail prices.

a March, *b* June, *c* September, *d* March, *e* June, *f* September, *g* December.

semi-durable goods, which were depleted during the war, further depresses the tendency to save out of current incomes. Expectation of future price increases probably also contributes to an increase in consumer demand out of a given income. The tendency to reduce the rate of savings was further aggravated by shortages of food. Prior to the war, when supplies of necessities were adequate, even the fairly low income groups in France saved a part of their income. With the shortages of food and other necessities after the war, many who normally saved some part of their income now spent all of it in the attempt to secure adequate supplies.

At the same time, the requirements for savings resulting from the budget deficit, from investment in building, equipment and inventories, and from hoarding of goods are higher in relation to income than before the war. The result of the lower tendency to save and the higher requirements for savings is inflation and a change in the distribution of income to the disadvantage of the lower income groups.

The requirements for savings are equal to the Government deficit plus capital formation at home minus the net imports. The table below presents a rough estimate of the ratio of the requirements for savings to the value of consumption.

Table 20

DERIVATION OF RATIO OF REQUIREMENTS FOR SAVINGS TO VALUE OF CONSUMPTION

	1938	*1946*
	(Thousand million francs)	
1. Government expenditure in current prices	108	877
2. Government revenue in current prices	55	485
3. Deficit in current prices	53	392
4. Net imports in current prices[1]	8	149
5. Consumption in 1938 prices	340	276
6. Consumer price index	100	645
7. Consumption in current prices	340	1,780
8. Private investment in 1938 prices[2]	48	54
9. Ratio of government deficit to consumption in current prices[3]	0.156	0.220
10. Ratio of net imports to consumption in current prices	0.024	0.084
11. Ratio of investment to consumption in 1938 prices	0.141	0.196
12. Ratio of savings requirements to consumption in current prices[3 4] (9 − 10 + 11)	0.27	0.33

[1] For 1938 the net interest receipts from abroad have been eliminated from the credit side of the balance of payments because it was assumed that interest receipts from abroad are largely saved. For 1946 no adjustment was made because it was assumed that net interest receipts were zero. The elimination of this item means that we deal only with the problem of the need for savings out of home-produced income. The figure for 1938 is from *Revenu national français*; that for 1946 is from *Etudes et Conjoncture*, December 1946, January 1947, page 271.

[2] It is doubtful whether the estimate for investment includes data on inventories and speculative hoarding of commodities. The magnitude of the inflationary problem is therefore probably understated at this point.

[3] The use of official prices to inflate consumption tends to understate the money value of consumption, particularly for the first half of 1946, and thus to overstate the ratios of government deficits, net imports and savings requirements to consumption. It does so, however, only because it fails to take into account the degree of inflation which actually occurred. Thus real wage rates also fell more than is indicated by the use of official price statistics in table 21.

If we used an index of 750 instead of 645 to allow for the understatement of consumer prices, the ratio of savings requirements to consumption would be 0.31 in 1946 instead of 0.33.

[4] It is assumed in this calculation that prices of investment goods rose in the same proportion as prices of consumption goods.

The ratio of savings requirements to consumption, and therefore to private income, was significantly higher in 1946 than in 1938. Since the tendency to save out of private income was much lower, the result could only be extreme inflationary pressure.

In the absence of adequate controls, this inflationary pressure has reflected itself in a rise in prices relative to wages, which has brought the tendency to save into equilibrium with the savings requirements. The rise in food prices has raised the relative income share of peasants, who tend to save a larger portion of their income than urban workers. Other prices, however, have also increased in relation to wages, thereby raising the relative share of profits and lowering the relative share of wages. These shifts occurred despite the beneficial effects of the partial controls upon the real value of low incomes.

Data on the relative share of wages in private income in 1946 are as yet unavailable. The data on wage rates, however, show that real rates at the end of 1946 were below 1938 by over forty per cent,[1] compared with a drop of about ten per cent in total real income. Although productivity, too, was lower than before the war, the decline was much less than that in real wage rates.

Table 21

INDICES OF MONEY AND REAL WAGES

Period	Weighted indices of wage rates All France: Skilled Workers	Unskilled Workers	Cost of living Paris [1]	Real wage rates [2]
October 1938	100	100	100	100
October 1940	104	103	—	—
October 1944	231	248	291	82
April 1945	314	304	325	95
October 1945	380	369	460	81
April 1946	395	379	491	79
October 1946	518	477	858	56

[1] See footnote 2 to table 16.

[2] Arithmetical average of wage indices for skilled and unskilled workers divided by cost-of-living index in Paris.

Source: *Etudes et Conjoncture,* No. 5-6, pages 121 and 130.

[1] The level of real wages at the end of 1946 cannot be compared with real wages expressed in terms of the official index in 1945 and the first half of 1946, because the price index in the second half of 1946 reflects the actual price situation much more accurately than in the earlier periods. However, the index is probably fairly comparable with the pre-war situation.

At the end of 1946, the French Government tried to tackle the problem by a campaign for a first general price cut of five per cent, which was followed by a similar one in March 1947. The campaign met with some success which was probably made possible by the influence of the Government's attitude on speculation in commodities. In May prices resumed their upward trend.

The inflationary pressure in 1947 appears to be no less and may even be greater than in 1946. The plans current early in 1947 called for a roughly proportionate increase in consumption and investment and in the budget deficit but for a somewhat smaller increase in imports. The Government is at present considering various proposals to reduce the budget deficit. As a part of this programme it has recently decided to reduce or eliminate the subsidies paid out on many goods. Although such an action reduces the budget deficit, it does so only by raising the prices of essential goods. It is difficult to see how the inflationary pressure can be effectively reduced without a thorough-going reform in the tax structure.[1]

The situation has recently been considerably aggravated by the very poor yield of the 1946-47 crop. Bread rations have already been reduced, and food prices on the free market are subject to upward pressure. This situation calls for a rise in food imports, but an increase is difficult owing to the extremely precarious French exchange position. France has been paying for its net imports through receipts from loans and sales of gold and foreign assets, and its dollar reserves have dwindled, just as have those of the United Kingdom. The dollar scarcity, through its pressure on imports of necessities, is one of the most critical elements in the present French inflationary situation.

3. *Italy*

Section 1. The economic situation at the end of the war

At the end of the war the Italian economy was in a state of dislocation very similar to that of France. Italy lost one-third of its capital, including more than eighty per cent of its merchant marine, about fifty per cent of its locomotives and thirty per cent of electric power installations. The loss in industrial capacity due to the war has been estimated at about twenty per cent. The effect of war damage was greatly increased by the lack of imported raw materials and fuel, on which Italian industries were always dependent. (Approximately sixty per cent of the fuel requirements had to be imported before the war.) The grain production dropped far below the pre-war level and the livestock was reduced by slightly less than one-fourth of the pre-

[1] In 1946 income taxes represented only three per cent of the national income in France, compared with over twenty per cent in the United Kingdom.

war figures. In 1945 agricultural production represented about sixty per cent of the pre-war level and industrial production twenty-five per cent.

The system of controls which operated under the fascist regime broke down almost completely in the course of prolonged fighting in Italy. A new system embracing the whole country was put into operation only at the beginning of 1946.

The breakdown of the control system released a tremendous inflationary pressure. The substantial budgetary deficit[1] and Allied expenditure increased the demand, which could not be met by the declining production and supplies. There was a considerable pent-up demand in terms of liquid savings accumulated during the previous period. As a result, prices increased rapidly. In October 1945 the price index of ten commodities (the prices of which are not controlled and which include only two foodstuffs) rose to 3,698, and the food index (free market and rationed products) rose to 2,889 (1938 = 100).

As a counterpart of this extremely rapid price increase, the pressure of pent-up demand in terms of liquid savings, as roughly indicated by the ratio between the quantity of money and the value of national income,[2] was entirely absorbed before the end of 1945. (In France this process took place in 1946; cf. page 40.)

Table 22

QUANTITY OF MONEY AND NATIONAL PRODUCT

	1938	*1945*	*1946*
1. National product (Thousand million 1938 lire)	110	55.4	75.0
2. Price index for inflating national income	100	2,270	3,000
3. National product (1 x 2) (Thousand million current lire) . . .	110	1,250	2,250
4. Total quantity of money[1] (Thousand million lire; at the end of the year)	77.5	795.6	1,233.9
5. Index of the ratio of quantity of money to current value of national income: 1938 = 100 . . .	100	90	78

[1] Includes Bank of Italy notes, American lire and State notes, deposits and current accounts.

Source: *Italy's Economy in 1947* (Report submitted by the Italian Government to the Fifth UNRRA Council); UNRRA Italian Mission, Supplement to Economic Notes, Vol. 1, No. 27; Instituto Centrale di Statistica: *Bolletino Mensile di Statistica.*

[1] Cf. table 25, page 48.
[2] Cf. table 22.

The elimination of pent-up demand has not, however, solved the problem of inflation. Important inflationary factors, similar to those analysed in connexion with France, are still active in the Italian economy. Before analysing their effects, it is necessary to describe briefly the functioning of the present control system.

Rationing of foodstuffs is limited to cereals, fats and sugar, which together represent more than three-quarters of the pre-war caloric value of the Italian diet. The domestic supplies of rationed products are made available by a system of forced deliveries of the entire surplus of the farmers of such products. During the food year 1945-46, prices of forced deliveries of cereals were comparatively low because the Government was anxious to keep down the cost of living and at the same time was reluctant for fiscal reasons to increase the cost of the bread subsidy. The unfavourable price relationship between major agricultural products and industrial products, as well as the high prices of grain on the black market, provided a strong incentive to farmers to withhold grains from delivery, which consequently fell substantially short of the expected collections. This system was maintained during the next food year, but the Government increased the official prices to bring them more into line with the prices of other commodities.

Control of foreign trade was exercised by the Allies up to 1946, and thereafter by the Italian Government. As no nationalization measures have been introduced, trade and industry are mainly organized on a private basis.[1] Official prices exist in the case of rationed goods, inclusive of those delivered by UNRRA, for other UNRRA deliveries, for products of State monopolies and for some important industrial products connected with allocation measures, such as solid and liquid fuel, leather, cement and steel. With these exceptions, the market is legally free. There is a serious black market in almost all commodities subject to price control.

Under these conditions, the control system could not effectively reduce the pressure of inflationary forces. Nevertheless, rationing, together with the bread subsidy, slowed down the re-distribution of real income in favour of higher income groups and prevented a fall to the starvation level in the consumption of the lower classes.

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[1] There is, however, a State-controlled holding agency, *Instituto per la Ricostruzione Industriale* arising from salvaging operations in 1933 when it took over the three largest banks and their industrial holdings. The I.R.I. controls ninety per cent of the merchant marine, seventy-five per cent of pig-iron production, forty-five per cent of steel capacity and to a lesser degree electrical power, mining, chemical production, shipbuilding, etc. The Government has not so far attempted to utilize the I.R.I. for planning purposes.

Section 2. The economic situation in 1946

In spite of a remarkable recovery in national production, the inflationary pressures were still very strong in the Italian economy in 1946.

The problem of inflation was the same here as in other devastated countries: a large increase in the requirements for savings and a simultaneous decrease in the tendency to save. The latter was due primarily to the fact that the real income was still far below the pre-war level.

The development of real national income is shown in the following table:

Table 23

National product

	1938	1945	1946
	(*Thousand million 1938 lire*)		
Agriculture	40.7	24.3	32.5
Industry	37.6	9.4	17.0
Commerce	9.8	4.2	6.5
Rents	6.4	5.5	6.0
Professional persons' activity	17.3	12.8	14.0
	111.8	56.2	76.0
Cost of banking	−1.8	−0.8	−1.0
Total	110.0	55.4	75.0
Index (1938=100)	100	50	68

On the other hand, the requirements for savings grew to unprecedented heights in relation to the national income. The main factor was the huge deficit, shown in the following table.

Table 24

Government expenditure, revenue and deficit [1]

	1937–38	1938–39	1944–45 [2]	1945–46 [2 3]	1946–47 [3 4]
		(*Thousand million lire*)			
Government expenditure	38.7	39.9	360.0	546.0	896.0
Government revenue	27.5	27.6	60.0	149.0	286.0
Deficit	11.2	12.3	300.0	397.0	610.0

[1] Italian fiscal year begins July 1.

[2] The figures for 1944–45 and 1945–46 include the budget of the Allied Military Government in Northern Italy.

[3] Proceeds from the sale of Government imports financed from abroad are not included.

[4] The figures for 1946–47 are official estimations. The actual deficit at the end of the fiscal year was probably much higher.

Source: 1937–38, 1938–39 and 1944–45, *Italy's Economy in 1947* (report submitted by the Italian Government to the Fifth UNRRA Council); 1945–46, *Annuario 1947*, Confederazione generale dell'Industria italiana; 1946–47, Speech of the Minister of Finance and Treasury, 29 March 1947.

As a percentage of national income, government expenditures were on the whole not higher than pre-war, whereas revenue decreased considerably. This was to a great extent due to the distortion in the tax structure and the inefficiency of the tax collection system. As a result, the deficits in 1945 and 1946 were more than twice as high in relation to the national income as in 1938.

Table 25

GOVERNMENT EXPENDITURE, REVENUE AND DEFICIT AS PERCENTAGE OF NATIONAL INCOME[1]

	1938[2]	*1945*[2]	*1946*[2 3]
Government expenditure	35.7	36.2	32.0
Government revenue	25.1	8.4	9.7
Deficit	10.6	27.8	22.3

[1] For national income cf. table 22.

[2] The estimates of government expenditure, revenue and deficit for each calendar year which were used to calculate the ratios in the table were derived by averaging the estimates of the two fiscal years which include the relevant calendar year.

[3] Computed on the basis of official estimations of revenues and expenditures.

The inflationary pressure generated by the budget deficit was increased by Allied spending and was reduced by net imports.

In 1938, the negative balance of trade was covered by freight and tourist incomes. For 1945 and 1946, no reliable figures are available to show net imports in current lire. For the year 1946, the proceeds from goods imported and sold by the Government, which are not included in the budget but go into a special fund, amounted to about 100,000 million lire.[1] The anti-inflationary effects of the government imports were, however, offset to a considerable extent by the net exports in the private foreign trade and by the Allied spending, and thus could not have a major significance in the reduction of inflationary pressures.

Furthermore, the requirement for savings was probably increased in relation to the national income by private investment and hoarding. Private investment in relation to the national income is unlikely to have been lower than before the war, and hoarding of commodities — *inter alia* livestock hoarded by peasants — probably existed in some measure and added to inflationary pressure.

Despite the beneficial effects of the partial controls on the real value of low incomes, the inflationary rise of prices resulted in a redistribution of national income unfavourable to lower income groups and was reflected in a very low level of real wages. Attempts to lift this level through money wage increases unsupported by tight controls resulted in new price increases.

[1] This figure includes the net proceeds from the sales of UNRRA supplies.

The following data, although far from being comprehensive, give some idea about price movements.[1]

Table 26

PRICES IN ITALY

	Florence Avanguardia index[1]	Edison Index, Milan[2] "Official prices"	Edison Index, Milan[2] "Actual prices"	Cost of living, national index (food only)[3]
	Wholesale prices, 1938 = 100			*1938 = 100*
1945				
Fourth quarter	3,691			3,068
1946				
First quarter	3,329			3,384
Second quarter	3,012	2,219	4,628	3,530
Third quarter	3,056	2,529	4,650	3,008
Fourth quarter	3,973	2,979	6,067	3,421
1947				
First quarter	4,917	3,409	6,758	4,502

[1] The Avanguardia index covers ten commodities (of which only two are foodstuffs) for which there is no official price and distribution control. Source: *UNRRA Italy Economic Letter,* December 1946.

[2] The Edison index covers 51 commodities. The index of "official prices" is based on official prices in the case of commodities subject to price control. In the index of "actual" prices, black market prices are substituted for "official" prices. Source: *Congiuntura Economica.*

[3] The index is based on a food budget giving a daily average consumption of 1,700 calories to each member of a family of five persons. Account has been taken not only of official prices for rationed foodstuffs, but also of the ruling prices for those bought on the free market. (On a weighted average basis, non-producers' rations, inclusive of supplements and special rations, provided a daily *per capita* intake of 869 calories in January 1946; 745 calories in June 1946; and 1,145 calories in December 1946.) Source: *UNRRA Italy Economic Letter,* December 1946.

As will be seen, the trend of prices in 1946 was not uniform. Prices seem to have achieved some measure of stability in the first three quarters of the year, and this in spite of increases in money wages in this period. This was probably due to the rapid increase in the real national income, in particular in the industrial sector.

[1] The data seem to be better than the French figures for 1946. As stated above, the sharp rise in French indices in 1946 was to a great extent due to the readjustment of official prices and did not adequately reflect the actual changes in the price level. Table 26, on the other hand, contains separate indices of official and actual prices and, as in the case of foodstuffs, a combined index of both official and free market prices.

Table 27

GENERAL INDEX OF INDUSTRIAL PRODUCTION, 1946[1]

(1938 = 100)

January	25.0	July	55.5
February	26.6	August	53.7
March	32.4	September	59.6
April	41.2	October	57.1
May	49.3	November	51.5
June	53.4	December	48.0

[1] The general index does not include housing construction, food processing, mechanical and electrical equipment manufacture.

Source: *Notiziario della Confederazione generale dell'Industria Italiana*, 5 July 1947.

The stabilization of prices was, however, very short-lived. In the fourth quarter, prices rose rapidly as a result of a further rise in money wages, while the supply position not only did not improve, but even deteriorated. The industrial production decreased in the fourth quarter of 1946, mainly owing to shortage of power.

SECTION 3. THE PROBLEM OF UNEMPLOYMENT

In addition to the problem of inflation common to all devastated areas, Italy, unlike other European countries, has a tremendous problem of unemployment.

The registered unemployment has increased since 1945, and in 1947 amounts to more than two million people. The actual unemployment is much higher, and is estimated at two and a half million. The situation is paradoxical inasmuch as unprecedented unemployment is maintained in spite of an excess of effective demand.

It should be obvious that the present Italian unemployment is fundamentally different from the problem of unemployment in industrialized countries, which results from deficiency of effective demand. In highly developed countries the existence of unemployment implies that there exists idle industrial equipment which can be put into use as soon as an increase of effective demand is brought about by private investment or government spending. An adequate increase in effective demand will in such a case result in full employment. If, however, the volume of equipment is lower than the volume required to employ the available labour, the increased effective demand will result in inflation. It follows that the co-existence of inflation and unemployment in Italy can be traced to shortage of equipment and key materials in relation to available manpower.

The lack of adequate data on employment and productivity makes it impossible to ascertain to what extent the present unemployment

is due to a fall in production as compared with pre-war. It is certain, however, that employment has fallen much less than output because productivity is low and part-time work is widespread. It seems fairly well established that a considerable proportion of the present unemployment is due to the increase in the visible supply of labor.

Unlike most of the European countries, Italy shows a steady growth of population at the rate of about 400,000 yearly. The losses of manpower caused by the war were incomparably smaller than in any other country. Although in wartime the average yearly natural growth of population was lower than in previous years, the increase in the population since 1938 to date amounted to 2.3 million. Before the war, only a small proportion of the increase in population could find regular employment in industry or agriculture. Emigration, which acted as a "safety valve" reducing the unemployment, dropped from an average of 250,000 in the twenties to about 92,000 in 1931–35 and 49,000 in 1936–40. Under the fascist regime, part of the increase in population was absorbed in various militias, police and standing army. But the major part was added to the inactive or partly active population. As the high rate of growth of population has not been matched by a correspondingly rapid increase in productive activity, there has always been a large structural unemployment, mostly in agriculture. To a great extent it was a "disguised" unemployment. The rural population was above the level justified by the size and the requirement of the farms.

The war and post-war years brought this disguised unemployment into the open. (The situation shows a great similarity to that in India. See page 67.) Part of the unemployed and partly employed either were drafted, or left the countryside to work in war industry, or fled from the approaching battle lines. A large body of people was thus left without occupation at the end of hostilities, and is now seeking employment. Former members of fascist militias etc. should also be added to this category.

The specific problem of Italian unemployment could be radically solved only by a long-run process of expansion of industry and agriculture. For the present, the Government is bound to resort to such expedients as public works and emigration. Since 1945, the Government has undertaken public works on an ever-increasing scale.

It can be seen from table 28 that only a very small proportion of unemployed could find jobs in public works in 1946. Further expansion of public works does not seem very likely. In 1946–47, the expenditure on public works (330,000 million lire) represented more than half of the budget deficit of 610,000 million lire. In the provisional budget for 1947–48, the expenditures on public works amounted to only 260,000 million.

Table 28

AVERAGE DAILY EMPLOYMENT ON PUBLIC WORKS CARRIED OUT OR CONTROLLED BY THE MINISTRY OF PUBLIC WORKS[1]

	Average daily employment	*Index*
1945	75,847	
1946		
January	117,633	100
February	123,807	105
March	169,728	144
April	168,208	143
May	164,484	140
June	166,232	141
July	193,683	165
August	203,514	173
September	241,528	205
October	275,233	234
November	268,667	228
December	246,672	210

[1] As some public works are controlled by other Ministries, the total employment on public work is somewhat higher than shown by the figures.

Source: *Congiuntura economica,* April 1947.

Emigration may alleviate unemployment to some extent. A number of emigration agreements have been signed in 1947. Some of these agreements provide Italy with an additional advantage of priorities for coal deliveries proportionate to the employment of Italian emigrants in coal mining of the respective countries. Thus the agreement with France provides for the import of 330 pounds of coal per miner daily and the agreement with Belgium for 3.5 tons per miner monthly. On the basis of emigration agreements already reached, 250,000 workers may go abroad in 1947 (200,000 to France).

It will be seen that both the public works and the emigration programme appear inadequate to mitigate the problem of unemployment in 1947.

SECTION 4. RECENT DEVELOPMENTS

The situation with respect to inflation and unemployment has not improved in the first half of 1947, in spite of a further increase in production.

The most prominent feature of the Italian economy in 1947 has been a considerable increase in inflationary pressure due probably to an increase in the budget deficit, which, for the fiscal year ending June 30, was much higher than estimated. At the same time, money wages moved upwards.

The Edison index of official wholesale prices of manufactured goods increased from 3,179 in December 1946 to 4,604 in June 1947. The index of "actual" free market prices rose from 6,598 in December 1946 to 10,594 in June 1947. The cost of living in June 1947 was about forty per cent higher than in December 1946.

In these circumstances, hoarding and speculation probably increased very considerably and, together with the factors previously mentioned, contributed to the sharp increase in prices.[1]

The situation is aggravated by the prospect of poor crops in 1947–1948 as a result of adverse weather conditions. It is estimated that the current crop will be only a little over five million tons and the amount of grain available to the Government pools will be slightly over one million tons, as against 2.3 million for 1946–1947. The difference will have to be covered by additional imports. Industrial production, however, after having continued to decrease in January and February, is again increasing as a result of larger supplies of coal and electricity. Production of coal in Sardinia increased by thirty per cent, and the production of electricity exceeded the 1941 level.

Coal allocations were comparatively large during the first half of 1947. Thus, the July–September allocation of coal, inclusive of bilateral agreements together with the domestic production, bring coal supplies during that period near pre-war levels. This, however, presupposes that Italy is financially able to purchase the coal allocated to her and at the same time secure other essential supplies from abroad. The exchange position is still difficult. Thus, the Prime Minister on June 9 estimated the gap in the balance of payments for the remaining part of the year at about 200 million U. S. dollars, after having taken into account the loan earmarked and now accorded to Italy by the Export-Import Bank, the relief aid from the United States, and the unfreezing of Italian assets in the United States.

With regard to the budgetary problems, the Government intends to reduce expenditure and increase revenue. The decrease in expenditure is to be obtained mainly by reduced spending on public works and elimination of the bread subsidy. Such measures will, however, result in a rise in the controlled price of bread and tend to increase unemployment. The increase in revenue is expected to come (apart from the price increases) from the capital levy and from new taxes on war profits and speculation. It seems, however, that without a radical reform in the tax structure and a more efficient administration of tax collection, the revenue will not amount to an appreciably greater percentage of the current national income than in 1946.

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[1] The Edison index of actual wholesale prices was in January 1947 6,796; February, 6,536; March, 6,943; April, 8,430; May, 10,157; June, 10,594.

4. *Poland and Yugoslavia*

SECTION 1. THE ECONOMIC SITUATION AFTER THE LIBERATION

A. *The reconstruction problem*

Before the war, Poland and Yugoslavia were primarily agricultural countries. In Poland, two-thirds and in Yugoslavia three-fourths of the gainfully occupied population were engaged in agriculture. Agricultural products accounted for a large part of total exports. The density of agricultural population in relation to arable land was high, and there existed substantial agricultural over-population. Partly as a result of land reforms carried out after World War I, small holdings were the prevailing type of land-owning. (In Poland about fifteen per cent of the arable land still belonged to big estates.) With the exception of church property in the case of Poland, the big estates remaining in both countries were broken down after World War II.

Although both countries had important resources in raw materials and fuel, industry was little developed. In Poland, the changes in boundaries after the war provided a substantial gain in industrial capacity.

Poland and Yugoslavia were heavily devastated by the war. Livestock was reduced by more than half the pre-war figures. The loss in industrial capacity resulting from military operations etc. was heavier than in most other devastated countries, and the transportation system in general was in such poor condition that a great number of trucks had to be imported by UNRRA in order to enable the countries to distribute relief supplies from abroad.

Loss of manpower due directly to the war amounted to about six million people in Poland and 1.7 million in Yugoslavia. In post-war as compared with pre-war Poland, the agricultural population decreased by thirty-five per cent, while arable land was reduced by only eighteen per cent. Together with the land reform, this contributed to a great extent to solving the problem of agricultural over-population. There is a serious lack of skilled manpower in both countries owing to particularly heavy losses in this category and to lack of training during the war and, in Poland, to the expulsion of the Germans.

During the first months following the end of hostilities, production was at unprecedented low levels. The crops were small not only because of the effects of the war, but also because of unfavourable weather.

Table 29

	Total production of cereals 1944-45 as percentage of pre-war	*Industrial production at the end of 1945 as percentage of pre-war*
Poland[1]	39	25
Yugoslavia	50	30–35

[1] Poland within its present boundaries. Industrial production was fifty-eight per-cent of pre-war production within the old boundaries (Polish Institute of National Economy).

Sources: *Economic Recovery in the Countries assisted by UNRRA,* UNRRA, Washington, D.C., September 1946; *Food and Agriculture in Yugoslavia,* Operational Analysis Paper No. 23, UNRRA, London, February 1947.

The fall in national income is particularly serious in countries like Poland and Yugoslavia, where according to available estimates the pre-war national income *per capita* was not more than $95[1] and $81 (U. S. currency) respectively.

As a result of war devastation and losses in manpower, the output of consumption goods — especially of food — was bound to be much lower than before the war, even after the dislocations which arose during the period of liberation were overcome. On the other hand, the requirements for reconstruction were very high. (Even if it had been decided that the rate of investment should be low, it would not have substantially increased the supply of consumption goods and services. It would merely have reduced the level of employment because there would be no adequate industrial capacity and supplies of materials for the production of consumption goods to employ the available manpower.) This resulted in a high ratio of production of investment goods to that of consumption goods. The inflationary problem inherent in this situation may be solved by a comprehensive system of controls and rationing which would keep the demand for consumption goods in equilibrium with supply at a certain fixed price level. The main difficulty in the application of such a system in countries like Poland and Yugoslavia is in the procurement of the entire surplus of agricultural products from small peasant holdings, which is the basis of an effective rationing system. In other words, it was difficult to introduce an effective government buying monopoly for agricultural produce. For a variety of reasons Yugoslavia found it easier to solve this problem than Poland, and as a result the free market plays a much smaller role in its economy than in Poland.

[1] Poland within its old boundaries.

B. *The economic pattern*

1. THE POLISH SYSTEM

The Polish economy is divided into three institutional sectors:

(*a*) The nationalized sector, comprising in general all industrial enterprises employing more than fifty people in one shift (in practice, the limit is frequently higher), the main credit institutions, the transport enterprises and forests;

(*b*) The co-operative sector, which is mainly engaged in trading; and

(*c*) The private sector, comprising agriculture, small industries, handicraft and trade enterprises.

The Government plans both the utilization of existing productive capacities and capital investment in the nationalized sector.[1] The co-operatives work in close connexion with the Government and act as its purchasing agencies for agricultural products. However, the major part of trade is in private hands.

With two important exceptions, the internal market is essentially a free one. The first exception is related to prices which are charged in transactions among the nationalized industries, and between such industries and other public units. Such prices are based on costs and contain a comparatively small margin of profits. The commercial prices of products which are sold to the non-nationalized sectors are determined by market conditions.

The other exception is related to the rationing system. Only a part of the food supplies for the towns is distributed through it, while the rest is available in the free market. Only a part of the population receives the rations, mainly those working in the public sector. The ration card holders are divided into categories with regard to the quantities of the rationed products they receive. The first category includes Government officials, municipal officials, and employees of the nationalized sector and their families; the second, pensioners, widows, orphans etc.; and the third, workers in private and co-operative enterprises. The ration cards for this last category have been recently cancelled.

The supplies for the rationing system were obtained through a system of forced deliveries from the farmers in 1945–46. This system created dissatisfaction among the farmers and proved to be difficult to enforce. Deliveries fell short of expectations, even though the Government attempted to compensate for the unfavourable relationship

[1] The plan for the period 1946–49 is presented in *The Polish National Plan* published by the Central Planning Board, Warsaw, 1946.

between prices of forced deliveries and prices of industrial products, by supplying the farmers with the latter products at exceptionally low prices. The Government therefore abolished the system of forced deliveries in the summer of 1946. The necessary domestic supplies to cover the rations are now purchased by the Government at free market prices, while rations are sold at very low official prices, and the difference is covered by the Government. Throughout the period of UNRRA activities the UNRRA supplies were distributed through the rationing system together with food purchased at home by the Government.

2. THE YUGOSLAV SYSTEM

As in Poland, the larger industrial establishments, transport and banking are nationalized, and operations in the nationalized sector are planned by the Government.[1]

In contrast to Poland, however, the free market plays a rather small role in Yugoslavia. The system of distribution is almost completely controlled by the Government. The wholesale trade is fully in the hands of Government, and co-operatives and the retail trade to a large extent. A substantial proportion of all available food is distributed through the rationing system. All important industrial consumption goods also are either rationed or distributed on a permit basis. All the population receives rations, but rationing is on a differential basis (for instance, workers in heavy industry receive higher rations). Producers' goods for the agricultural population are also distributed on the basis of a schedule of priorities. Prices of most non-rationed goods are subject to control, which is made possible by the fact that wholesale and retail trade are under Government control. (If these goods are scarce, the result may, of course, be haphazard distribution.)

Apart from UNRRA supplies, which have come to an end, the food distributed through the rationing system is obtained mainly through forced deliveries from the peasants, purchased at fixed prices. While initially these deliveries were to absorb all the surplus over personal consumption of the peasants, the system was changed in 1946 to allow the farmers to retain a part of the surplus according to a graduated scale. The peasants are permitted to sell the retained surplus at free prices. These sales constitute the main part of the free market in Yugoslavia. Additional supplies for the rationing system are obtained from the peasants by means of contracts for voluntary deliveries, in return for which the peasants obtain priorities for industrial goods.

[1] The Yugoslav plan for the period 1947–51 is presented in the "Decree Establishing a Five Year Plan for the Development of the National Economy of the Federal People's Republic of Yugoslavia for the Years 1947–1951", Belgrade, 1947.

The contracts, of course, reduce the quantities of food available in the free market. The collection of food from the peasants is facilitated by the fact that the bulk of the cereal surplus is concentrated in one region (Voievodina). It may be seen from the above that the Yugoslav system is in practice very similar to that existing in Great Britain. The main differences are (*a*) the existence of a limited free market in food in Yugoslavia; (*b*) the reinforcing of price control in that country by the influence the Government exerts upon distribution through co-operatives and Government shops. Any changes in the demand and supply position with regard to essential commodities are reflected only in the free market for agricultural products. It should be added that the prices of rationed products are by no means so low as compared with free prices as in Poland.

As a counterpart to the rather comprehensive price control outlined above, wages and salaries in Yugoslavia are controlled by the Government, both in its own undertakings and in private enterprises. The basic premise of the Government policy is that money wages should remain stable, while real wages may be expected to rise as a result of falling prices due to a general increase in productivity.

C. *Currency reform and fiscal measures*

In addition to the direct influence exercised by the Government upon the price and wage system, the currency reform and the fiscal system should be considered as an important link in the solution of the problem of inflationary pressure.

Almost simultaneously with the Liberation, the various currencies in circulation were converted into a unified currency. In Poland, the conversion reduced the known currency circulation by sixty-five per cent. In Yugoslavia the circulation was reduced from about 250,000 million old dinars to about 6,000 million new ones, or slightly less than the currency circulation at the end of 1938. In both countries, bank deposits had not increased during the war by nearly as much as the currency circulation. Banking accounts, as well as the amounts of currency presented but not exchanged, were blocked and virtually eliminated.

This currency reform curbed the immediate danger of inflation through the virtual elimination of past accumulated savings. Moreover, it created a great scarcity of cash, which, in the absence of substantial bank credits for the private sector, was an important factor in mitigating the inflationary pressure exerted by the budget deficit in the subsequent period.

Since Poland and Yugoslavia have large nationalized sectors, it is appropriate to consider the budgets of their public sectors as a whole, rather than their ordinary State budgets. The revenue of the public

sector consists of proceeds from the sale of net imports, receipts from taxation, and profits realized by the nationalized enterprises. The expenditure in addition to administration, subsidies, etc. consists of investments in Government enterprises.

Net imports were made available mainly by UNRRA. In the case of Poland, medical supplies were distributed free. Food supplies went directly into the rations and were distributed at prices which roughly covered the internal distribution costs. Moreover, UNRRA imports of capital goods either contributed directly to the capital formation of the nationalized sector or were sold to farmers, who paid for them by instalments. The proceeds from the UNRRA supplies, therefore, came mainly from the sale of petrol and cigarettes. In Yugoslavia, the situation was rather similar with regard to UNRRA imports of capital goods, but as prices of rationed goods were not as low in relation to other prices as they were in Poland, the proceeds from UNRRA deliveries were on the whole more important.

As to tax revenue, indirect taxation (especially the turnover tax) is still of primary importance, although great efforts have been made to improve the efficiency of direct taxation.

The nationalization policy naturally puts at the disposal of the Government the total profits of the nationalized enterprises. To this extent it eliminates the necessity for taxation of corporate profits. On the other hand, the Government has to finance the investments of such enterprises.

In neither of the two countries have the revenues of the public sector, taken as a whole, been sufficient to cover their expenditure.

Section 2. Production and prices in 1946

In both countries, the national output has considerably increased since 1945, especially in the industrial sector. The increase in agricultural production was rather slow as a result of a poor harvest in 1946, mainly because of bad weather conditions and persistent shortages of draft power and fertilizers. The progress of reconstruction in Poland may be seen from table 30.

Real wages increased in Poland by about thirty-five per cent from the beginning to the end of 1946. However, real national income and consumption *per capita* in 1946 were on the average still only seventy-three per cent and sixty-seven per cent of the pre-war level within the old frontiers.

In both countries, especially in Poland, there were substantial deficits in the public sector, financed mainly by the issue of notes. Although during the war and the Liberation there were in both countries very large price rises which might have caused a lack of confidence in the currencies, in 1946 prices rose in a much smaller

Table 30

AVAILABLE GOODS AND SERVICES IN POLAND 1945-1946

	Polish Production					
	Industry, trade and communications	Agriculture	Total	UNRRA imports	Excess of all other imports over exports[1]	Total available goods and services
	(Millions of dollars in constant prices)					
1945						
Second quarter	170	175	345	5	—	350
Third quarter	300	180	480	22	— 3	499
Fourth quarter	350	185	535	65	— 6	594
1946						
First quarter	435	190	625	78	—20	683
Second quarter	455	195	650	122	— 1	771
Third quarter	485	205	690	73	+ 5	768
Fourth quarter	500	210	710	34	+17	761

[1] Allows for normal trade, special coal exports to the Union of Soviet Socialist Republics under August 1945 agreement, imports in the form of United States surplus property and rolling stock and reparations.

Source: UNRRA Mission to Poland.

proportion than currency circulation, as may be seen for Poland from table 31. (It should be noticed that bank credits to private sectors were very small, so that the accumulation of cash could be done almost solely out of current income.)

Table 31

COST OF LIVING AND CURRENCY CIRCULATION IN POLAND

	Cost of living in Warsaw based on free prices (1937 = 100)[1]	Currency circulation at the end of the months[2] (Millions of zlotys)
December 1945	8,950	26.3
March 1946	10,150	26.9
June 1946	11,040	36.7
September 1946	10,650	44.5
December 1946	13,020	60.1

[1] Source: United Nations *Monthly Bulletin of Statistics.* The index is based on free prices in Warsaw. There exist large local variations in prices, mainly because of transport difficulties.

[2] Source: Polish official data. The banking system is on the whole nationalized, and banking accounts are almost exclusively held by the nationalized sector and used for transactions within that sector. For comparison with the cost of living based on free prices the size and the rate of increase in banking deposits is therefore irrelevant.

This development of the free market prices in Poland may be explained as follows. First, a substantial increase in supply created an increasing need of cash for transactions. Furthermore, there was a considerable cash scarcity created by monetary reform. Currency circulation at the end of March 1946 (when its rapid increase started) was seventeen times as high as in 1937 while prices of consumption goods at the free market were about one hundred times as high and the volume of market transactions in consumption goods was not less than 0.4 of pre-war level. This means that the value of transactions in March 1946 had increased more than forty times and the quantity of money only seventeen times. This scarcity of currency provided an inducement for accumulating cash.

Cash might also have been accumulated as a result of lack of other opportunities for investment of current savings. Hoarding of goods was rendered inconvenient to some extent by the fear lest this serve as basis for evaluation of direct taxes etc. The investment of savings as a whole in foreign currencies was impossible because of the more or less fixed supply of such currencies. The tendency to invest in dollars was reflected merely in a rise in their unofficial rate of exchange.

It may be asked who is doing the saving, larger enterprises having been nationalized, while the standard of living is very low and all goods are available at a price in the free market. The explanation lies in the fact that many traders, small manufacturers and also some rich peasants in Poland make fairly high profits, and it is out of these incomes that the accumulation of cash reserves is forthcoming.

Section 3. Recent developments

The progress of reconstruction continued in 1947 in both countries. The food position, however, deteriorated considerably. The most important factor was the reduction and finally the discontinuation of UNRRA deliveries coming after the rather disappointing harvest in 1946. Moreover, the severe winter in Poland destroyed a large part of the seed and created additional requirements for grain to be re-sown. In spite of all efforts, the 1947 crop is likely to be poor.

The scarcity of food not only affects the health of the population, but has important repercussions upon economic stability.

In both countries, cuts in rations or cancellations of ration cards of some categories of ration holders had to be instituted. In Poland, this causes the following developments within the price system.

(*a*) People deprived of rationed food spend more on food out of their income and less on other goods. The food prices increase in consequence. The prices of other goods do not tend to fall as a result,

because the peasants spend their increased income and thus the total demand for non-food commodities is not reduced.

(*b*) The Government still has to buy at least as much as previously for the rationing system. (The rations are cut or cancelled on account of a reduction in foreign supplies.) As a result of the increase in food prices it has to pay more in the free market, and this swells the budget deficit.

(*c*) This increases the demand for all sorts of goods and thus exerts an upward pressure on their prices. As a result, the Government is able to raise the prices of products manufactured by the nationalized industries. This counters the increase in the budget deficit. Nevertheless, in the process an over-all increase in prices is taking effect, and real wages are reduced. The cost of living in Warsaw increased from the end of 1946 to May 1947 (in terms of free market prices) by thirteen per cent, while money wages did not change substantially.

In Yugoslavia, the cutting of rations increased the price of food in the free market. However, the prices for compulsory deliveries were in general unchanged, and as a result the price system as a whole was affected less than in Poland.

Allowing for weather conditions, the agricultural production in both countries certainly has a tendency to increase and will make them self-sufficient in terms of food in the not too distant future. However, for the time being, the prevailing scarcity of food, as elsewhere in Europe, imposes a great strain upon their economies.

PART III

INFLATION IN UNDER-DEVELOPED COUNTRIES

1. *India*[1]

SECTION 1. THE WARTIME INFLATION

During and since the war India has suffered a greater degree of inflation than many other non-devastated countries. In order to explain the present situation in India it is necessary first to examine the manner in which inflationary pressures were set up during the war. The trend of prices as measured by the official indices, set out in the following table, provide a good starting point.

Table 32

CHANGES IN WHOLESALE PRICES AND COST OF LIVING IN INDIA SINCE 1939

(Average of monthly prices: 1937 = 100)

	1939	*1940*	*1941*	*1942*	*1943*	*1944*	*1945*	*1946*	*1947*
Wholesale prices	95	113	122	149	215	227	231	252	274[1]
Cost of living (Bombay)..	100	106	117	148	218	224	222	244	258[2]

[1] June. [2] April.

Source: United Nations *Monthly Bulletin of Statistics.*

During the early years of the war price increases were fairly moderate, but a sharp rise took place in 1942 and 1943. From the end of 1943 to the end of 1945 prices were relatively stable, and in 1946 and 1947 there was again a marked increase.

In this section of the review we shall deal with events up to the end of the Japanese war in the latter part of 1945. The subsequent period will be dealt with in the following section.

[1] This report was written prior to the partition of India, and therefore does not take it into account.

While these price indices reflect the general trend of inflationary pressures in India, they do this imperfectly. Owing to weaknesses in transport (intensified by war demands on the system) and poor market organization, regional price variations in India are wide. Moreover, actual market prices, both in the towns and in the rural areas, were certainly often in excess of controlled prices.

The main source of inflation was the increase in government expenditure for military purposes. War expenditure increased rapidly to a high figure in the budget of 1943-44 and then became relatively stable around this high level until the end of the war. These expenditures were provided by budget deficits which had an inflationary effect. Incomes increased as a result of mobilization into the army and by an expansion of total employment to meet military needs.[1] In so far as military needs were met by diversion of production they resulted in a reduction of civilian supplies. As there was very little expansion, and with respect to some consumption goods a contraction in output, the process necessarily resulted in a steep rise in prices. The rise in prices increased the incomes of manufacturers, large landowners, peasants and traders. Wages in the organized industries rose, but less rapidly than prices, while wages of other workers lagged far behind. The pressure of demand arising out of the higher incomes caused prices to rise still farther in a cumulative manner, real wages falling considerably in the process.

The budget deficits fall into two clearly defined parts—the deficit on the Indian budget proper, which arises from the expenditure and revenue of the Indian Government on its own account, and the addition to this deficit due to "recoverable" war expenditures made by the Indian Government on behalf of the British Government. (The "recoverable" war expenditure was covered by the British Government through depositing sterling securities with the Reserve Bank of India, which could then issue rupees in India for expenditure by the Indian Government. The sterling balances thus acquired by the Government of India mounted up as a debt of the British Government.)

The budget deficits for the years 1939-40 to 1946-47 may be set out as follows.

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[1] About two and a half million men were recruited into the armed forces, and about 700,000 additional workers were absorbed into industry, both mainly from rural areas.

Table 33

BUDGET DEFICIT

	1939-40	*1940-41*	*1941-42*	*1942-43*	*1943-44*	*1944-45*	*1945-46*	*1946-47*
	(Millions of rupees)							
Budget deficit on Indian account..	—	65.3	126.9	1,121.7	1,897.8	1,611.4	1,449.5	440
Recoverable war expenditure of Imperial Government	40	530.0	1,940.0	3,254.8	3,778.7	4,108.4	3,470.7	416.6
Total effective deficit:	40	595.3	2,066.9	4,376.5	5,676.5	5,719.8	4,920.2	856.6

Source: *Report on Currency and Finance for the year 1945-46*, Reserve Bank of India.

The increase in net exports also contributed somewhat to inflation. This influence, however, was of minor importance as compared with that of the budget deficit.

	1939-40	*1940-41*	*1941-42*	*1942-43*	*1943-44*	*1944-45*	*1945-46*	*1946-47*
	(Millions of rupees)							
Positive trade balance	483	417	797	841	931	212	234	150

Source: Accounts relating to the Sea-borne Trade and Navigation of British India.

Private investment (which has an effect on the economy similar to a budget deficit or to net exports) was falling as a result of the control of new capital issues and of the limitation of imports of investment goods. This, however, reduced the inflationary pressure only to a minor degree.

On the side of production, although in certain branches of industry there were some developments that were new to India and in others increases in output that were large compared with pre-war figures, the increases in output of basic commodities were on the whole relatively small. The following table shows the trend of production in some of the more important industries:

Table 34

INDUSTRIAL PRODUCTION IN INDIA

	Cotton piecegoods (Million yards)	*Cement (Thousand tons)*	*Steel ingots (Thousand tons)*	*Pig iron (Thousand tons)*	*Coal (Thousand tons)*	*Electricity (Million k.w.h.) (monthly averages)*
1938–39.....	4,269.3	—	—	—	—	182
1940–41.....	4,269.4	1,727	1,285.4	1,961.0	26,005	204
1941–42.....	4,493.4	2,247	1,363.1	2,015.0	26,463	214
1942–43.....	4,109.3	2,183	1,299.1	1,804.2	25,470	225
1943–44.....	4,870.6	2,112	1,365.5	1,686.4	22,483	227
1944–45.....	4,726.4	2,075	1,253.9	1,300.4	24,154	279

Sources: *Monthly Survey of Current Business Conditions in India;* United Nations *Monthly Bulletin of Statistics; Report of the Advisory Planning Board,* New Delhi, December 1946.

As concerns food, not only did the price increase fail to bring about an expansion of food grain production in India but factors were at work causing a reduction in market supply, thus aggravating inflation.

One factor was the shortage of manufactured goods, which, coupled with very imperfect market conditions, did not create an incentive to peasants to offer their surplus grain on the market.

Another factor working in the same direction was the reduction of the burden of the mortgage debts through the increase in farm prices. Thus, many peasants were able to retain more food for their own consumption. Furthermore, speculative hoarding developed, particularly by large landowners and traders.

A factor that became operative after 1942 was the reduced volume of food imports due to the loss of Burma. At the very low standards on which most of the population lives, India is practically self-sufficient in food production and normally imports relatively small quantities of rice and other grains. Nevertheless, these marginal quantities imported are of very considerable importance in the market economy of India, since the major quantity of Indian grain production does not come on to the market at all, but is directly consumed by the cultivators.

The above factors, coupled with a disruption of transport by war demands on the system, resulted in a critical situation in Bengal, which is a deficit area in respect of food grain production. If we do not overlook the natural and social conditions which expose India to the risk of periodic famine, it is correct to say that the Bengal famine of 1943 was largely a consequence of the inflation, coupled with administrative deficiencies on the part of the Bengal Government.

We have already referred to the fact that from the end of 1943 to the end of 1945 prices in India were relatively stable at a very high level as compared with 1939. Although the price indices, especially after the middle of 1943, reflect mainly controlled prices and thus under-estimate both the degree of inflation and the wide regional variations in prices, there are good grounds for supposing that after the middle of 1943 the rate of price increase was considerably reduced, and we must now consider why this is so.

There are two reasons which explain the development of a relatively stable situation.

First, the budget deficits reached a peak in 1943-44, and in the next two years were more or less stabilized at this high level.

The second reason is that the introduction of partial rationing allowed a reduction of prices as compared with what they would have been otherwise, even though it was not possible to fix prices completely. By July 1944 limited schemes of rationing were in operation in 226 towns with a total population of thirty-five million. Rationing

was confined to urban areas, and the amount of the ration varied from town to town. However, essential goods such as food grains, cloth, kerosene and sugar were almost universally rationed. Supplies of rationed goods to the urban areas were partly maintained by bulk purchases and distribution on the basis of average consumption during the five years preceding the war. Rationing, however, did not cover all market deliveries, and the prices of goods delivered into the rationing scheme had to be in some way adjusted to the market prices. However, it was possible at least to save on the trading margins both in purchasing and in retailing, which favourably affected real wages, especially of organized workers.

Outside the rather prescribed areas of rationing and in respect of non-rationed goods, more or less free markets existed and prices were generally unrestrained except by market forces. There was great regional variability of prices, as a result of which people in the rural areas suffered most. Also there was a good deal of black marketing in contravention of controls.

The relative stability of prices in this period should not mislead us into conclusions that the position was satisfactory at that time. The condition of unorganized workers, particularly in agriculture, and other low income groups had deteriorated seriously as a result of the preceding increase in prices.

Section 2. The post-war situation in India

The dominating influence during the period immediately following the end of the war was the rapid decline in defence expenditure and the budget deficits to which the war had given rise. This had its counterpart, of course, in the return to civilian life of demobilized soldiers and the reduction of orders for the products of war industries. We have seen that in the main the effect of the war was to divert Indian production to war needs rather than to bring about extensive new industrial development. Since no very profound structural changes were brought about in the Indian economy, it would appear that the transition to peace would be relatively easy. It would be a mistake, however, to give much weight to this apparently obvious conclusion. Two problems weigh heavily on the Indian post-war economic situation, in addition to the long-run problem of development—"disguised" unemployment and continuing inflationary pressures.

There is in fact already a problem of unemployment in India, though in the absence of any unemployment statistics it is impossible to estimate it except in the most general fashion. The Government's demobilization plan aimed at the return to civilian life of one and a half million men by the middle of 1947. Although the rate of demobilization has been slower than this, 900,000 men were returned

to civilian life by the end of 1946. Most of these have returned to the villages, where, for the present, they are living partly on demobilization allowances. It is unlikely that most of these will be absorbed into village life with its low standards of living, and as they will eventually be on the labour market, a large proportion of these ex-soldiers are properly to be regarded as unemployed. Only about sixteen per cent of ex-servicemen seeking employment through labour exchanges have been placed. In addition, there are the industrial workers who were absorbed into ordnance factories and military constructional work, for which there is now no demand. Up to the end of 1946 about 600,000 people belonging to this latter group had registered with employment exchanges and a substantial portion had not yet found employment. A certain percentage would no doubt obtain work without the assistance of the exchanges. Assuming these figures to be fairly representative, it may not be unreasonable to set the figure for unemployment in India due to the transition from war to peace at well over a million.

In the budget of 1946-47 there is a heavy fall in the defence expenditure compared with the previous year, and as a result a fall in the budget deficit from 4,920 million rupees to 856 million. This might have been expected to bring about a considerable reduction in inflationary pressures unless it were offset by contrary forces.[1] Actually, inflationary pressures were evidently still at work in India throughout 1946. Prices not only have not fallen since the end of the war, but have even risen considerably (see table 32). The present situation was summed up by the Indian Finance Member, the Honourable Liaquat Ali Khan, when presenting his first budget in February 1947, in the words: "Inflationary trends persist, prices are still running high, wartime shortages of consumer goods have not yet been materially alleviated, and production has been hampered by the inevitable delay in obtaining capital goods, by labour unrest and transport difficulties; in addition, there has been continuous anxiety about the food position."

There is no doubt, therefore, about the continued existence of inflationary pressures; but that unemployment should exist at the same time requires further explanation. Part of the explanation is the lack of tools and equipment upon which to employ workers at present unemployed. In the face of lack of equipment for industrial expansion the alternative means of employing the unemployed would

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1 Many Indian economists have expected a depression with an accompanying fall of prices to supervene in India when the heavy defence expenditure came to an end. See *Indian Journal of Economics*, January 1945 and January 1946.

be on public works. But such expenditure would intensify the inflationary pressures, for it would give rise to increased consumers income without leading immediately to any increase in consumption goods. In the circumstances the proper method of dealing with the problem would be to finance the necessary public works by taxation.

We should be clear at this stage as to the basis of our comparisons. In relation to the immediate pre-war years, when budgets were practically balanced, the deficits of 856 million rupees for 1946-47 and about 500 million for 1947-48 are considerable, and would create an increase in consumption demand as compared with pre-war years. But what is here to be explained is an upward trend of prices as compared with 1945, when the budget deficit was very much higher. In seeking this explanation we must look both to the supply situation and to the influences which may be at work to maintain consumer demand at something like the 1945 level. We pass on, therefore, to consider briefly the following points: A. The trend of private investment; B. Whether or not there is any considerable delayed demand; C. The supply situation.

A. *Private investment*

During the war, private investment in India was greatly reduced in the process of diverting output to war needs. Since the end of the war, import controls and other controls limiting private investment have been considerably relaxed. With profit margins in most branches of industry still running high, and with Japan out of the field for the time being, business expectations are favourable to investment. There was also considerable delayed demand for investment, and the financial means for this existed in the liquid reserves which were the counterpart of the wartime budget deficits. Some evidence of an increase in private investment since the end of the war may be found in the figures for the production of cement and steel.

Table 35

AVERAGE MONTHLY PRODUCTION OF CEMENT AND STEEL IN INDIA

	Cement	Steel ingots and castings
	(*Thousand tons*)	
1938	119	82
1943	179	115
1945	187	108
1946	171	104

Source: United Nations *Monthly Bulletin of Statistics.*

As these are both products which were heavily in demand for military purposes during the war, they would tend to suffer from the

decline in defence expenditure. The fact that there was no very great fall in output compared with the peak years of the war makes it reasonable to suppose that private investment demands have considerably filled the gap left by the decline in military outlay.

B. *Delayed demand for consumption goods*

There is a similar problem in regard to consumption goods, since some consumers, just as did producers, accumulated liquid savings as a counterpart of the budget deficits. A large part of these reserves was concentrated in the hands of the small class of large landowners, the traders and the industrial capitalists. These people, whose income was greatly increased during the war, doubtless spent a good deal of it. Nevertheless there were many things which were simply unobtainable.

Such a delayed demand is for imported rather than for home-produced goods. There must exist, however, a certain range of Indian commodities which are in varying degrees substitutable for imported commodities. The fact that many consumption goods which were expected to be available by importation very shortly after the end of the war are not yet available in large quantities, must have increased the tendency to substitute local products.

To these classes, whose ability to accumulate savings is unquestioned, we may add rich peasants and small traders. (It is probable that wartime savings among such people took the form of hoarding notes.) This has increased the total demand for products of local production since the end of the war, for the delayed demand of these peasants would most likely be for cloth of qualities not available during the war, for simple farm implements, for repairs postponed during the war years, and for a number of other locally produced goods.

Whether this delayed demand is large or small is difficult to establish with certainty. On the grounds we have presented, there is a reasonable presumption that it has had some significance in maintaining the pressure of demand. It is accordingly worth while to consider the change in the rate of turnover of cash balances between 1939 and 1945. As a crude indication of this, we compare the rate of increase in cash balances (bank deposits and notes in circulation) with increases in the price index, though it must be allowed that some part of the discrepancy shown in this comparison is due to an increase in output.

Table 36

CASH BALANCES COMPARED WITH PRICE MOVEMENTS

	Total cash (Bank deposits notes)	Notes only	Bank deposits only	Wholesale prices	Cost of living
1939	100	100	100	100	100
1945	450	505	400	247	245

Source: United Nations *Monthly Bulletin of Statistics.*

These figures show that the volume of cash balances increased more considerably than prices during the war; that is to say, there was a fall in cash turnover, or—what is the same thing—an increase in cash liquidity. It will be noticed that the increase in cash liquidity was greater in regard to notes than in regard to bank deposits, and this fact may appear to lend some support to the suggestion that there was some hoarding of notes. This evidence of the delayed demand is by no means conclusive, however, for in a country such as India it is probable that before the war there was generally a shortage of cash. Therefore some increase in liquidity (which is in fact expressed in a fall in rates of interest as compared with pre-war) was to be expected with an increase in the quantity of cash. At the very least, however, these figures give some support to the reasons suggested above for supposing that delayed demand has had some appreciable effect in maintaining total demand.

C. *The supply position*

In the face of demand continuing at a high level, the supply of commodities not only could not be increased, but in some cases was diminished in 1946 as compared with 1945.

Owing to world shortages, India has not been able to augment by imports the supply of food and equipment on the internal market. The inability to obtain machinery and other capital equipment hampered the expansion in the output of India's own production of industrial consumption goods.[1] This is a temporary condition, but while it lasts it contributes to the inflationary trends in India.

Expansion of agricultural output presents a more difficult problem, since this is bound up with the whole structure of Indian society, with systems of land tenure, the subdivision of plots and the primitive methods of cultivation which poverty and custom impose upon the peasant. In 1945-46, owing to unfavourable weather conditions, crops were generally below the previous year, and the Indian Government, conscious of the danger of famine, secured some wheat imports through the Combined Food Board. The estimate of total wheat production for 1945-46 shows a decrease of four per cent in acreage under wheat and a decrease of sixteen per cent in total output as compared with the previous year.

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[1]Although the Government of India has recently greatly strengthened import controls to prevent the use of dollars for the import of non-food consumption goods, it is the physical shortage of food and capital goods rather than the shortage of dollars which has limited their importation.

The food situation has continued to be precarious in 1946-47 because of a poor harvest, making it necessary for the Indian Government to seek further food grain imports. Such imports do not appear likely to be sufficient, however, to relieve the situation entirely. Measures have been taken to attempt to increase the internal food output by improved water supplies through the sinking of wells, increased supplies of fertilizer and improved seeds. However, in the short run these can have only a limited effect. The Indian Government has furthermore extended the system used in some provinces during the war of assessing the surplus crops which should be available for the market and acquiring this surplus by more or less compulsory purchase.

This situation is not stable, for it is partly determined by forces which are of only a temporary nature. Putting aside for the moment the large-scale development programmes which are now contemplated, the inflationary forces now at work would probably be overcome. Delayed demand, which is one of the influences at present helping to maintain a high pressure of demand, is bound to exhaust itself. On the other hand the estimated budget deficit for 1947-48 is about 500 million rupees; that is, about one-tenth of the peak wartime deficits. In the absence of development expenditure the volume of consumer demand would therefore probably fall in the not too distant future. It is also probable that the supply position will improve owing to an increase in imports, especially of capital goods, which would make possible an increase in the supply of manufactured products. This should result in some rise of employment, although the unemployed may not all be absorbed in this way.

Section 3. The problem of industrial development

The major economic problem for India is not the maintenance of full employment in the sense in which this is a problem in a highly industrialized community such as the United States of America, but to overcome through a large-scale process of development the consequences of under-employment characteristic of a community with a large agricultural population using rather primitive methods and only partially developed industrial resources. Since, however, development requires heavy investment expenditure, the experience of the wartime inflation should be of great value in approaching the problem of handling a large increase in investment. We shall therefore examine in the light of our previous analysis some of the plans which have been suggested as a basis for India's industrial development.

There has been a great deal of discussion in India on planned industrial development, and a number of plans have been formulated.

The most widely publicized, and in form the most comprehensive of these plans, is the so-called Bombay Plan, the product of a group of Indian industrialists, first published under the title of "A Plan of Economic Development for India" in January 1944. The Indian Federation of Labour also published a plan on similarly comprehensive lines, though rather less detailed and with more ambitious targets. Both these plans are based on the notion of increasing the national income over a period of years at a pre-determined rate. During the war official schemes for reconstruction and development over a five-year period, covering agriculture, transport, education and public health were drawn up by the Provinces and the Central Government. Recently there has been published a report of the Advisory Planning Board of the Interim Government on such schemes, without a formulation of a comprehensive plan with over-all targets such as the Bombay Plan has used. (It takes the view that statistical information is not sufficiently developed for this purpose.) The five-year development projects of the provincial governments and the Central Government are estimated to cost about 13,000 million rupees. This includes railway development, but omits estimates for investment in other industrial development. If the production targets suggested for the steel, cement, paper, textile and other industries in the report of the Advisory Planning Board were to be accepted in a general plan, the total investment expenditure would probably involve an annual investment for development of the same order of magnitude as that visualized in the early stages of the Bombay Plan.

It is therefore important to try to answer the question: how much investment expenditure can be undertaken without serious inflation? In order to give a quantitative basis to the discussion we shall make use of the targets set by the Bombay Plan. This does not imply any judgment on the intrinsic merits of the Bombay Plan, which is used for this purpose solely for the reason that it defines an over-all rate of investment and the methods of its financing.[1]

The Bombay Plan aims at trebling the national income of India within fifteen years, from an estimated twenty-two thousand million rupees to sixty-six thousand millions which, allowing for an estimated increase of population of five millions per annum, would result in doubling the income per head at the end of fifteen years.

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[1] One point may be made, however, as it has a bearing on the problem of inflation. The Indian Federation of Labour Plan, though setting higher targets than the Bombay Plan, meets the inflationary danger more effectively in that it relies on taxation for part of the investment funds and also gives greater stress to an increase in agricultural production. Similarly the report of the Advisory Planning Commission gives considerable weight to increasing food output.

These increases in income are to be brought about by planned investment covering the fifteen years period and spread over the main groups of activities as set out below.

Table 37

CAPITAL EXPENDITURE ENVISAGED BY BOMBAY PLAN

	Millions of rupees
Industry	44,800
Agriculture	12,400
Communications	9,400
Education	4,900
Health	4,500
Housing	22,000
Miscellaneous	2,000
Total	*100,000*

The sources from which savings equal to 100,000 million rupees over fifteen years are to be achieved are visualized by the authors of the plan as follows:

	Thousand million rupees
1. Hoarded wealth	3
2. Sterling securities	10
3. Balance of trade	6
4. Foreign borrowing	7
5. Savings	40
6. "Created money"	34
Total	*100*

The first four items in the above list presumably represent sums that would be spent abroad on imports necessary for the execution of the plan. Hoarded wealth refers to private accumulations of gold. The item "Balance of trade" is a little ambiguous, but it has evidently been reached by multiplying India's pre-war annual balance of trade by fifteen, the number of years for which the plan will run. It is assumed, that is to say, that imports would be increased annually by 400 million rupees by forgoing this export surplus. The meaning of items 2 (sterling securities) and 4 (foreign loans) is unambiguous. The remaining two items, 5 and 6, may be considered as one, since they represent the investment amounts which will be spent in India and for which there must come into existence an equivalent amount of savings at home.

As we have seen, the plan is based on the investment of 100,000 million rupees spread over a period of fifteen years. As the plan comes into effect, income will cumulatively increase and the amount of investment will increase with it from 2,140 million rupees in the first year to 13,600 million in the fifteenth. Since investment is expected to rise roughly in the same proportion as income, its inflationary effects may be illustrated by consideration of the problem in the first year.

A fraction of the investment expenditure will be spent abroad, and only the amount spent at home is relevant to the problem of inflation. Over the whole period of the plan 26,000 million rupees of the total of 100,000 million is to be applied in this way, being derived from the mobilization of hoarded gold reserves (3,000 million), sterling securities (10,000 million), increase of imports covered by the favourable balance of foreign trade (6,000 million) and foreign loans (7,000 million). If this proportion of investment in imports to investment at home is more or less uniformly maintained throughout the whole period of the plan, then about one quarter of the first year's investment of 2,140 million rupees would be spent abroad: Let us for the time being accept this proportion.[1] Then roughly 1,600 million rupees would be the amount of investment required to be financed at home in the first year of the plan. This amount, however, is based on 1933-39 prices, while present Indian prices are about two hundred per cent in excess of this, and therefore the amount required to be spent at home in the first year would be of the magnitude of 4,800 million rupees. This is approximately the magnitude of the peak wartime budget deficits. If the whole of the first year's home investment visualized in the Bombay Plan were to be financed without a drastic increase in taxation, it would roughly restore the unsatisfactory situation which existed in the last few years of the war, which was to a large extent responsible for the Bengal famine.

The inadequate food supply is the critical factor in the problem. It plays a fundamental role in the mechanism of Indian inflation. Even drastic taxation of higher incomes is unlikely to help considerably, because it is a poor instrument in curtailing food consumption of the well-to-do, while comprehensive rationing will involve great administrative difficulties. An increase in production and imports of

[1] We take this amount because it seems to be the maximum of home expenditure which would be required in the first year of the plan. If a higher proportion of the first year's investment were applied to the import of capital goods the inflationary danger would be reduced.

food, especially of dairy products, must be considered a cornerstone of any development plans. Rapid expansion of food production is, however, difficult to achieve, for the manifold reasons discussed above. It will also not be easy to finance food imports by enlarged exports, since some of India's present export products—cotton and jute, for instance—would be used in greater volume by local industry. Hence these exports not only could not be expanded, but would have to be reduced. Thus India would have to rely on a considerable expansion of exports of products of light manufacturing industry, which may prove difficult. It seems, therefore, that India will have to spend a part of its accumulated sterling balances, its mobilized gold treasure or foreign credits, at least in the early stages of its development, not only on equipment, but on food as well. This will either reduce the pace of development or require additional means for financing imports.

2. *Latin America*

Section 1. Inflation during and since the war

Inflation in some degree has been common to all Latin American countries since the beginning of the war. Although the extent of it has been different in different cases, there is a fundamental pattern which is common to the whole region.

Whereas in countries deeply involved in the war the inflationary pressure came from the budget deficits by which the war expenditures were financed, in most Latin American countries the pressure came mainly from the considerably enlarged value of exports and the reduced volume of imports. The table on pages 78-79 sets out the total value of exports and imports for the most important Latin American countries for 1940 and 1943-46, as well as for several months of 1947. (Although import values generally rose during the war, the rise was generally attributable to price increases rather than to increases in volume. In fact, as mentioned above, the volume generally fell.)

The expansion of the volume of exports and the rise in export prices during the war were caused mainly by the increase in the United States demand for the agricultural and mineral products which are the main exports of Latin America, and by the elimination of alternative sources of supply of these goods. Naturally the demand of the United States for these products tended to grow after it came into the war, both because of direct war requirements and because of increased incomes of consumers in the United States.

Other factors were also at work. One was the military investments by the United States Government (strategic bases in Brazil and Cuba,

Pan-American Highway in Central America, development of production of strategic materials for export, etc.). Moreover, government development expenditure financed by borrowing was of considerable importance in some countries, especially in Mexico and Chile. In addition, there appeared in many cases considerable deficits in administrative budgets caused both by the fall of revenue from import duties, as a result of the decline in the volume of imports, and by an increase in current government expenditure, especially in Argentina and Brazil.

Finally, there was a substantial increase in the investment of foreign companies in export industries and a considerable increase in residential building. The expansion of the latter often required fewer imported commodities than other investments in fixed capital and was very profitable in view of the pressing demand for housing resulting from an increase in employment and incomes in the larger towns. In many Latin American countries, especially in Brazil and Chile, a virtual building boom developed.

These primary increases in Latin American incomes resulting from the expansion of exports, budget deficits and investment created additional domestic demand for consumption goods. This was especially true where workers and peasants, who spend practically all they earn, shared in the increase in the value of exports (through the rise in employment or wage rates or through incomes being linked to export prices as in the case of sharecroppers or some categories of plantation workers). At the same time the available supplies of consumption goods were reduced owing to a fall in imports—*inter alia,* those of food—due to world scarcity of many goods and shortage of shipping. The excess of demand over supply brought about a great increase in price.

It is true that in response to price increases there was a rise in home production both of manufactured consumption goods and of food. However, this additional production added as much to income as to supplies. Thus it was available for meeting the primary rise in demand resulting from the higher incomes produced by higher net exports, budget deficits and investment, only to the extent to which the income generated by the production of consumption goods for domestic use was saved. The proportion of such income saved is probably smaller than in countries like the United States or the United Kingdom. The expansion in production required to offset the initial rise in incomes was therefore relatively large.

The increase in production was, however, limited by several factors. In agriculture a rapid increase in production is always difficult to achieve. Fluctuations in the weather and other adverse natural factors are more important in this respect than response to variations

Table 38

FOREIGN TRADE OF LATIN AMERICA

(Millions of U.S. dollars)

	1940			1943			1944		
	Total exports	Total imports	Balance	Total exports	Total imports	Balance	Total exports	Total imports	Balance
Argentina	414	381	+ 33	633	236	+397	681	258	+423
Bolivia	51	26	+ 25	85	39	+ 46	78	38	+ 40
Brazil	265	251	+ 14	469	309	+160	579	409	+170
Chile	143	104	+ 39	181	131	+ 50	198	149	+ 49
Colombia	72	85	− 13	110	84	+ 26	130	100	+ 39
Ecuador	11	11	0	28	16	+ 12	13	9	+ 4
Paraguay	6	8	− 2	11	12	− 1	14	13	+ 1
Peru	66	52	+ 14	71	69	+ 2	84	79	+ 5
Uruguay[1]	66	55	+ 11	100	64	+ 36	98	73	+ 25
Venezuela	153	98	+ 55	178	66	+112	265	163	+102
Mexico	—[2]	135	—	233	188	+ 45	216	278	− 62
Cuba	127	104	+ 23	351	177	+174	427	209	+218
Other countries[3]	79	96	− 17	124	138	− 14	162	151	+ 11

[1] Imports into Uruguay are valued at official values instead of c.i.f. value, so that they are undervalued by 20-35 per cent.

[2] Mexico valued mineral exports c.i.f. before 1941 and f.o.b. from 1941 on, so that export figures before 1941 are not comparable. There was probably a small export surplus in 1940.

[3] Total trade of Costa Rica, Guatemala, Honduras, Nicaragua, Panama, El Salvador, Dominican Republic and Haiti.

Table 38 (continued)

	1945			1946			1947		
	Total exports	Total imports	Balance	Total exports	Total imports	Balance	Total exports	Total imports	Balance
Argentina	729	289	+440	1,173	570	+603	—	—	—
Bolivia	79	27	+ 52	63	—	—	—	—	—
Brazil	661	442	+219	981	622	+359	314	263	+ 51[1]
Chile	211	156	+ 55	216	178	+ 48	50	55	— 5[1]
Colombia	140	160	— 20	193	220	— 27	—	—	—
Ecuador	28	24	+ 4	26[2]	34	— 8	—	—	—
Paraguay	22	18	+ 4	16	—	—	—	—	—
Peru	104	85	+ 19	151	123	+ 28	18	26	— 8[3]
Uruguay[4]	122	115	+ 7	151	147	+ 4	21	24	— 3[3]
Venezuela	338	240	+ 98	427	258	+169	—	—	—
Mexico	275	330	— 55	394	543	—149	72	112	— 40[3]
Cuba	410	239	+171	476	307	+169	78	66	+ 12[3]
Other countries[5]	155	169	— 14	205	223	— 18	—	—	—

[1] Three months.

[2] Trade figures for 1946 are estimated for Ecuador.

[3] Two months.

[4] See footnote 1, page 78.

[5] See footnote 3, page 78.

Sources: U.S. Department of Commerce, 1940-1946; United Nations *Monthly Bulletin of Statistics*, 1947.

in prices. Sociological conditions of land tenure, lack of credit facilities, standards of rural education, present not unchanging but nevertheless stubborn limits to the operation of improved techniques upon which any considerable increase in output depends. Transport facilities are also of vital importance, for where markets cannot be easily reached, producers have no incentive to increase production for sale. It is noteworthy that when agricultural production was increased it was very often of plantation crops for export, in respect of which transport facilities exist and credit facilities are ample. Thus the home markets did not by any means get the full benefits of such increases in production as took place.

The inelasticity of food supply was particularly important from the point of view of inflationary pressure, because in countries where standards of food consumption are low, as they commonly are in Latin America, a high proportion of an increase in income is apt to be spent on food.

The development of manufacturing industries was limited in rather different ways—namely, by the inability to secure imports of new equipment, by shortages of managerial and skilled labour, as well as by shortages of certain imported raw materials or fuel.

These factors explain the continuing inflationary pressure in Latin America during the war. The rise in prices caused an increase in the income of manufacturers, traders and peasants and was followed, although usually after long delays, by a rise in wages. The expenditure out of higher incomes exerted a new pressure on prices. As inflation proceeded, speculation developed to a considerable extent, and the consequent hoarding of goods increased the inflationary pressure still further. In the process, real wages fell considerably.

There was no effective price control in Latin America, because there was no effective rationing of consumption goods. Although it was undertaken in some instances, it was on too limited a scale to be effective. Price ceilings existed and still exist in many Latin American countries, and most of the price indices are often based on them; but market prices are usually above the ceilings. The latter are raised when the discrepancy becomes too striking.

After the war, exports from Latin America continued to increase. The rise in exports during this period was the result of the maintenance of a high level of employment and income in the United States, combined with the large scale of relief and lending to devastated countries, which created a considerable demand for Latin American goods. The easing of the shipping situation was an additional fac-

tor, because it permitted expansion of some Latin American exports which were reduced by shortage of shipping during the war (grain exports from Argentina are an important instance). As a result of these factors, Latin American exports increased in 1946 to a higher level than in any war year.

Imports into Latin America in 1946 did not increase sufficiently to mitigate the inflationary pressure. The obstacles to an increase in imports adequate to overcome inflation were the world shortage of certain important goods, especially of food and machinery, and the lack of adequate port facilities. In addition, some of the countries limited their imports of consumption goods, partly as a means of protecting local industries, and partly in order to continue to accumulate dollar reserves, which they planned to use for imports of industrial equipment.

For some countries, such as Mexico, imports had become considerable by 1946. Towards the beginning of 1947 this trend became more widespread. Imports from the United States into South America in the first six months of 1947 were double the imports in the last half of 1946.[1] Much of these increased imports in 1947 was accounted for by larger imports of machinery and equipment. In spite of the existence of exchange controls, however, imports in many cases included substantial items of unessential goods.[2] The inclusion in these increased imports of large quantities of investment and non-essential goods, such as automobiles, reduced their importance in mitigating the current inflationary pressure on the markets for essential goods.

Another factor in the maintenance of the inflationary pressure was the continuation of large-scale development projects in certain countries, especially Mexico and Chile. The delayed demand for investment also had a share in the inflationary situation. Certain investments were delayed because of the impossibility of importing machinery during the war. Now, when this machinery became available, the investment projects were realized. These required some meas-

[1] These changes appear in the following table:

	U.S. exports to Latin America	U.S. imports from Latin America
	(Millions of dollars)	
Second half 1946.....	642	566
First half 1947.....	1,241	628

[2] In order to cut down the proportion of luxury items included in imports, several countries such as Chile, Mexico, Brazil and Argentina have drastically tightened their import restrictions on non-essential goods.

ure of home investment, such as factory buildings.[1] Delayed demand for consumption goods was probably of some influence also.

Some indication of this delayed demand is given by a comparison of the growth of notes in circulation and bank deposits on the one hand with price increases on the other. The following table presents such a comparison for a number of Latin American countries between 1937, and 1946 and 1947.

Table 39

CASH BALANCES COMPARED WITH PRICE MOVEMENTS IN 1937, 1946 AND 1947[2]

(*1937 = 100*)

	Notes in circulation		Bank deposits		Wholesale prices		Cost of living	
Country	*1946*	*1947*	*1946*	*1947*	*1946*	*1947*	*1946*	*1947*
Argentina	353.5	366.1	259.1	283.4	208	217	159	165
Bolivia	667.9	669	480.3	482.1	—	—	533	—
Brazil	445.7	443.5	524.7	549.3	—	—	222	—
Chile	501	507.6	309.2	347.3	227	276	283	342
Colombia	490.6	450.9	480.2	456.8	—	—	207	238
Mexico	628.6	587.5	819.6	819.3	250	257	308	341
Peru	624	628.1	510.9	505.9	235	265	199	219
Uruguay	235.2	230.1	241.7	245.7	—	—	153	165
Venezuela	455	455.9	—	—	149	156	150	158

Source: United Nations *Monthly Bulletin of Statistics.*

It will be seen that in all cases there has been an increase in cash in relation to prices. Since the increase in output was in general limited, it is probable that cash balances rose considerably more than the value of transactions. Certain qualifications should be made in interpreting these figures, such as the fact that price indices probably underestimate the increase in prices and that a preference probably developed during the war for holding larger cash balances, especially

[1] Evidence of the increase in construction may be obtained from the following indices showing production of cement for the years 1944-1947 (1937 = 100).

	1944	*1945*	*1946*	*1947*
Colombia	229.4	247.1	271.6	265.7*
Bolivia	255.6	255.6	300	
Venezuela	250	250	275	
Brazil	141.8	135.5	144.3	
Chile	114.4	103	98.2	106*
Mexico	175.9	213.8	217.2	

* Four months.

Source: United Nations *Monthly Bulletin of Statistics.*

[2] 1947 figures are the latest available for each country, and are in no case later than May.

for business purposes. However, we may regard these figures as offering some evidence for the existence of delayed demand.

On the side of supply, the poor harvests in Cuba, Brazil, Mexico and Colombia in 1945-46 should be taken into account in the explanation of the maintenance of inflationary pressure.

This is the general pattern of inflation in Latin America, but it does not show itself in quite the same way in all cases. As regards the extent of price increases there is considerable variation, as is shown by the table below.

Table 40

INDEX OF COST OF LIVING

Country	*1944*	*1945*	*1946*	*1947*
		(1937 = 100)		
Bolivia (La Paz)	470	496	533	—
Chile (Santiago)	224	244	283	342[1]
Mexico (Mexico City; food, clothing, domestic help)	230	247	308	341[3]
Paraguay (food and clothing in Asuncion; 1938 = 100)	193	214	236	275[1]
Cuba (food prices only)	172	194	208 (10 mo. av.)	—
Brazil (Rio de Janeiro)	170	197	222	—
Peru (Lima)	163	182	199	234[3]
Costa Rica (San Jose)	167	177	184	208[3]
Argentina (Buenos Aires)	113	135	159	165[3]
Colombia (Bogota)	170	189	207	238[3]
Uruguay (Montevideo)	121	139	153	165[4]
Venezuela (Caracas, cost of food, coal and soap)	141	141	150	158[1]
United States of America	122	125	136	152[5]

[1] February. [3] April. [3] March. [4] January. [5] May.

Source: United Nations *Monthly Bulletin of Statistics*, June 1947.

In Venezuela and Uruguay, and until recently in Argentina, for example, price increases, according to the official cost-of-living indices, have been modest, whereas in Bolivia, Chile, Mexico, Brazil and Peru they have been very considerable. It should be emphasized that even official reports mention that the indices understate the degree of price increases.

Large net exports were not always associated with a large increase in prices. Chile had only moderate net exports, but its price increase was very steep. Mexico experienced considerable inflation even though it had net imports in 1941 and in 1944 and subsequent years. In both countries the inflationary pressure was caused to a great extent by budget deficits and expenditures on development.

Argentina, until recently, was a striking example of a country with a very large increase in net exports as well as government deficits, but with modest price increases. In part the phenomenon was apparent rather than real, because the rise in the cost of living in Argentina was underestimated by the index. With respect to manufactured goods even the official wholesale price index shows a very large increase. Nevertheless, in part the phenomenon was real. An important factor which helps to explain it is the fact that grain exports were actually reduced because of the shipping shortage. The supply of a basic food item at home was thus actually greater than before the war.[1] This not only prevented an increase in grain prices, but it also acted as a check on the rise in income of a large part of the population.[2]

The situation changed with the termination of the war. The increase in grain exports, associated with low crops in 1944 and 1945, led to a steep increase in the prices of grain, and its primary and secondary effects contributed to a great extent to the rise in the cost of living, which was rapid after the end of 1944. In 1947 the Government, which has a virtual monopoly of the marketing of wheat, reduced the purchase price from the farmers and at the same time sold wheat for domestic consumption at about a thirty per cent discount. The Government exports wheat at prices considerably in excess of the domestic buying price, and the net result of these operations is a substantial profit to the Government, which it expects to use for industrial development.

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[1] To prevent prices from falling the Government purchased the surplus at prices moderately higher than before the war and sold it for fuel.

[2] Another example is provided by Venezuela. There the mild increase in the cost of living is probably explained to a great extent by the peculiar nature of its exports and imports. The exports of Venezuela are largely accounted for by the oil companies, and imports of mass consumption goods into Venezuela are small. Until 1943 the net exports resulted primarily from a reduction in imports, which affected only slightly the supply of essential consumption goods. Subsequently there was a rise in exports of oil. However, since the production of oil is highly mechanized, the influence of this upon the purchasing power through the rise of employment was not very important. It should be mentioned in addition that the budget in Venezuela was strictly balanced, and that, in contrast to what happened in most other Latin American countries, budget deficits did not contribute to the inflationary pressures.

In Uruguay, a mild rise in prices also seems to be associated with a large increase in the net exports. However, the latter is apparent only because the imports were valued at conventional prices.

In the near future we may expect a continuation of the current trend of increased imports of machinery and equipment into Latin America. This will tend to relieve the inflationary situation by permitting an increase in the production of consumption goods. A lag will of course ensue between the time this equipment is imported and the time when it is installed and capable of producing goods. A limitation placed on the extent to which imports into Latin America will be expanded is the rapidity with which her gold and foreign exchange holdings are being depleted.

A halt to the inflation may also be caused by a decline in exports from Latin America. The re-establishment of alternative sources of supply disrupted during the war, which until the present has not been of consequence, will be an important influence in the long run. In addition, the stimulation of production in some countries in response to the high prices may result in an over-supply of some commodities, with a consequent fall in prices. There is already some evidence of this. An additional factor which may depress Latin American exports in the near future is the dollar shortage in Europe.

Should a depression in the United States develop, it might result not only in elimination of the inflationary pressure in Latin America, but even in reduced output and employment owing to the decline in exports to the United States and other countries. This would aggravate any decline in exports caused by the factors mentioned above. Latin America has become increasingly dependent on the United States market for the sale of its products. In 1945 over fifty per cent of its total exports went to the United States. In addition to the direct effect of a recession in the United States upon the demand for Latin American exports, there would also be a substantial indirect effect through the increased competition in the world markets of United States exports with Latin American exports. In view of the fact that most Latin American countries also depend on the export of one, two or three products, they are peculiarly vulnerable to changes in foreign demand.

For agricultural products a decline in demand would reflect itself to a greater extent in a decrease in prices, rather than in a decline in employment. For industrial materials the employment effect would be relatively greater.

With the fall in income and employment in the export industries, there would be a decline in Latin American demand for consumption goods. The first effect on home-produced goods would be a reduction in the prevailing level of scarcity prices. Whether there

would be a significant decline in total output and employment in the home industries would depend upon the magnitude of the primary reduction in the export industries.

Any unemployment which might develop as a result of the decline in exports could probably be eliminated by government development programmes without creating any significant inflation, even though the volume of imports for current needs might have to be reduced as a result of the fall in exports.

It is unlikely, however, that the Latin American countries would limit their development programmes and budget deficits only to the level required for the elimination of unemployment. Most countries have large-scale development plans and programmes designed not merely to eliminate any unemployment which might result from the decline in exports, but to develop their resources in order to diversify the output of the country and to provide for rapid economic growth. Some countries have already embarked on large-scale investment programmes. To the extent that these development programmes rely on imports of capital equipment they will not create any inflationary pressure. On the contrary, once the new equipment destined for the production of consumption goods goes into operation, it should reduce inflationary pressure by increasing production and effecting better distribution of consumption goods. To the extent to which the development projects involve domestic investment, however, they will increase consumer incomes and raise the demand for consumption goods, especially for food. The rise in incomes and in over-all consumer demand may be kept in check by a broad programme of tax reform. Even a rise in taxes, however, is not likely to solve the food problem for many countries, since the upper income groups are not likely to reduce their food consumption as a result of taxes.

With the probable exception of Argentina, expansion of food production also presents a difficult problem. In the longer run the food problem may be solved by social and technical measures for increasing agricultural production. In the shorter run, it may be necessary either to increase food production at the expense of other agricultural products which are now exported, or to import food. Both these measures would reduce net exports and would therefore require either a more rapid depletion of foreign balances accumulated during the war or additional loans. Otherwise, imports of capital goods would have to be reduced and industrial development would be retarded.

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